Constrained LNG (CLNG) Credits

Gas TCMF

6th November 2008

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Introduction

As part of considering the potential for credits for entry points with Negative Long Run Marginal Costs (LRMCs) we have considered the interactions with the existing CLNG methodology.

As a result we have reviewed the CLNG methodology and we believe that in its current form it does not appropriately incentivise National Grid to invest rather than use CLNG.

National Grid believes that it should invest where it is economic and efficient to do so.

The presentation will cover:

- an introduction to CLNG,
- the prevailing methodology,
- the issues with the prevailing methodology,
- a proposal to better support the long term incentive to invest where economic and efficient, and
- a consultation timeline.

Overview

Constrained LNG Facilities have historically been situated on the parts of the NTS most remote from the beach terminals.

Shippers booking the constrained LNG service agree to ensure the continuing availability of transmission support gas throughout the winter period on behalf of National Grid.

All constrained LNG sites provide a transmission benefit that is effectively in lieu of further investment on the pipeline system. It is therefore appropriate that a credit is offered to reflect the benefit obtained.

The credit is based upon the exit capacity charge of the exit zone or zones supported by the CLNG site and the volume of deliverability required.

In 2008/09 a constrained firm service is required at Avonmouth only.

Minimum Inventory

Users who book the Constrained LNG storage service agree to provide transmission support gas to National Grid on days of very high demand.

Users also agree to retain a minimum inventory level of gas in store so that transmission support gas is available all winter.

On each Day in each week in the Winter Period, a User's gas-in-storage in each Constrained Storage Facility shall not be less than the Weekly Minimum Requirement.

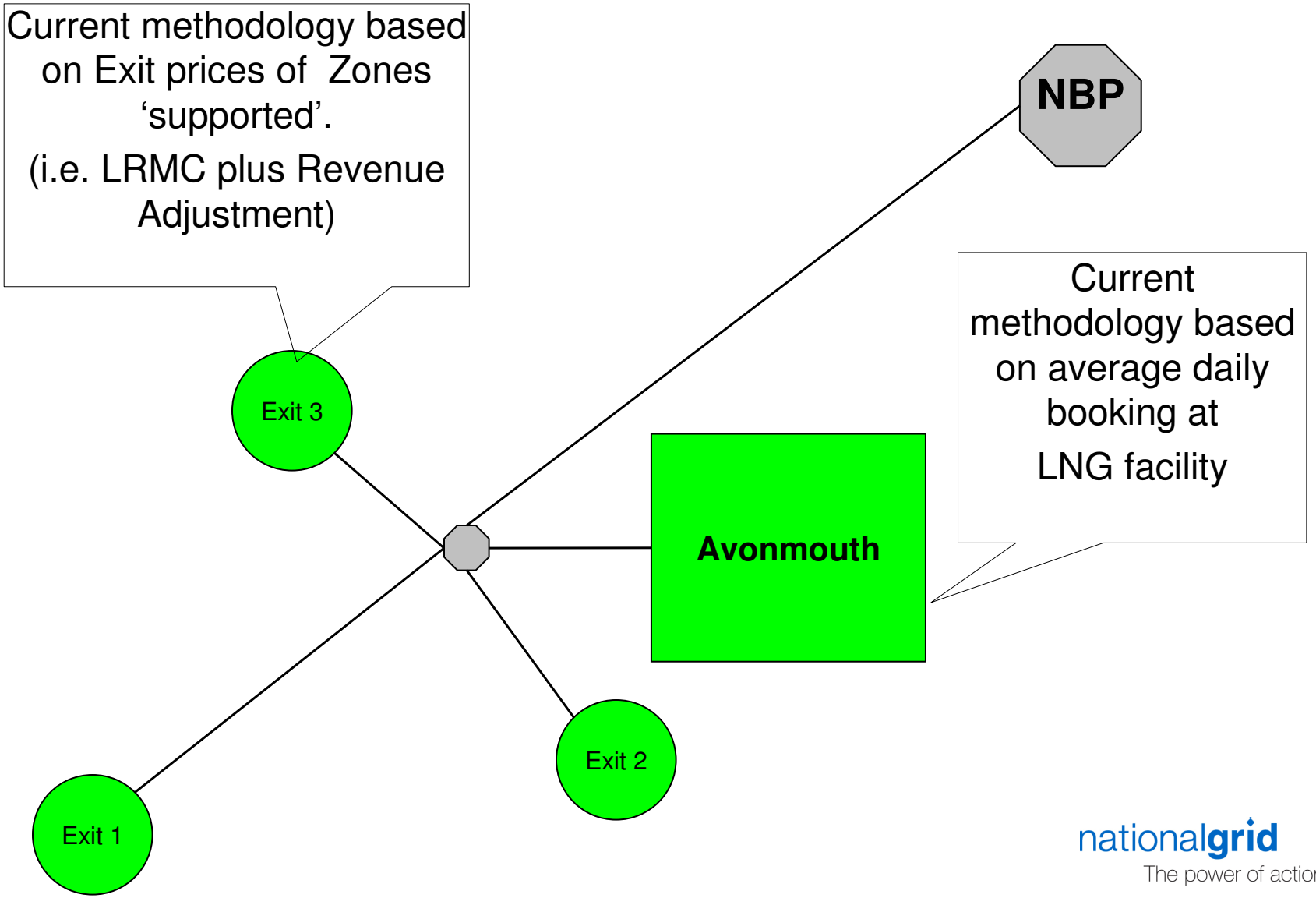
Constrained LNG Credit

Users who book the Constrained LNG storage service receive a 'transportation credit' from National Grid. This reflects the avoided investment in the pipeline system, in recognition of the transmission support provided through CLNG.

The 'credit' is based upon the exit capacity charge of the exit zone or zones 'supported' by the CLNG site and the volume required.

The 'credit' is subtracted from the price of 'bundled' capacity offered by the storage service provider.

Prevailing Methodology



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Issues with Current Methodology

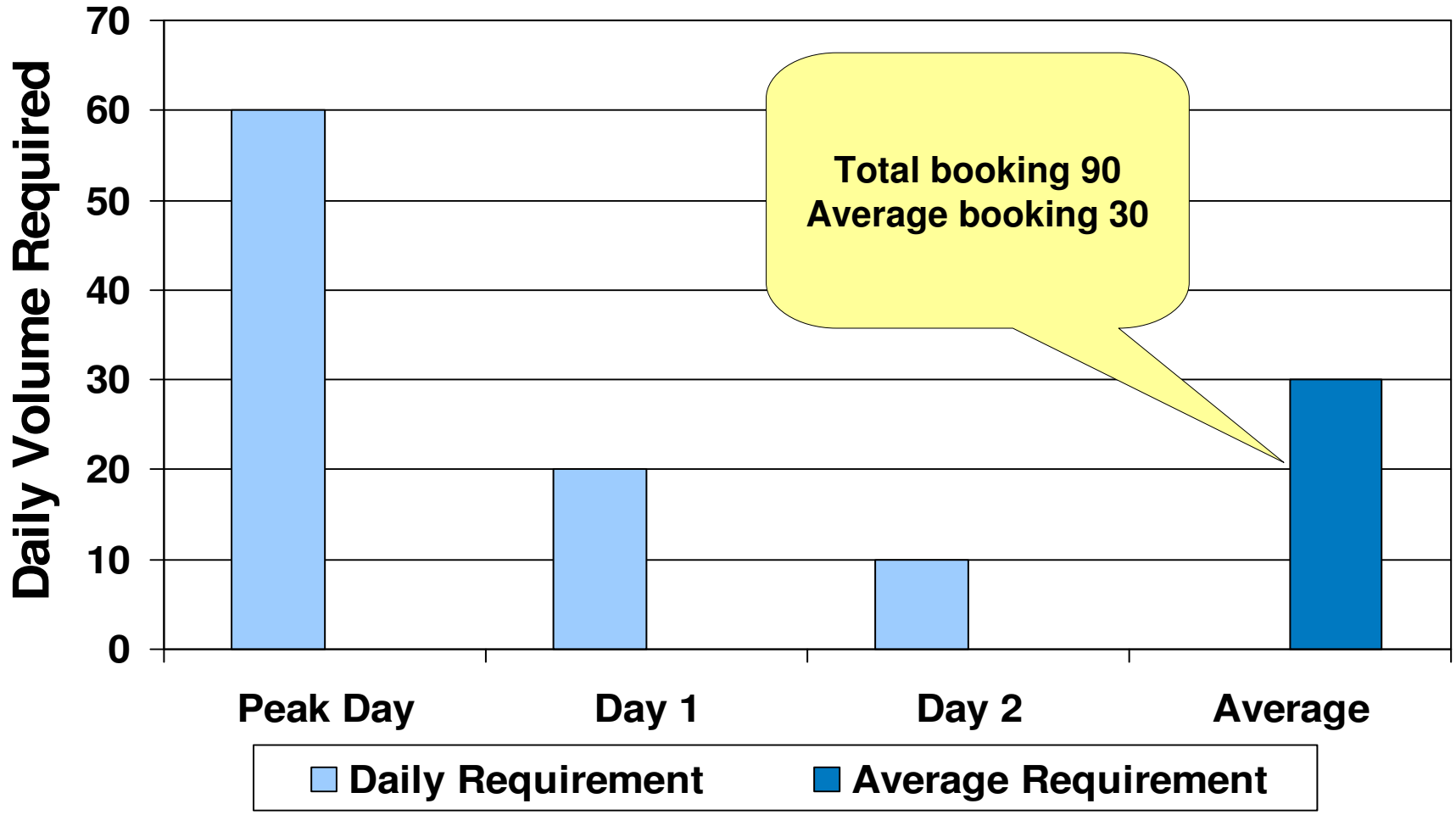
The issue with the current methodology is that it may not appropriately reflect costs because:

1. The credit is based on average storage deliverability but avoided investment is driven by peak storage deliverability.

2. The credit is based on exit zone charges, which include an adjustment relating to allowed revenue, rather than the LRMCs which reflect investment costs.

3. The constraint (avoided investment) is between the NBP and the CLNG Node. There is no constraint between the CLNG Node and the Zones 'supported'.

Daily Requirements vs. Average Requirements
Example Booking



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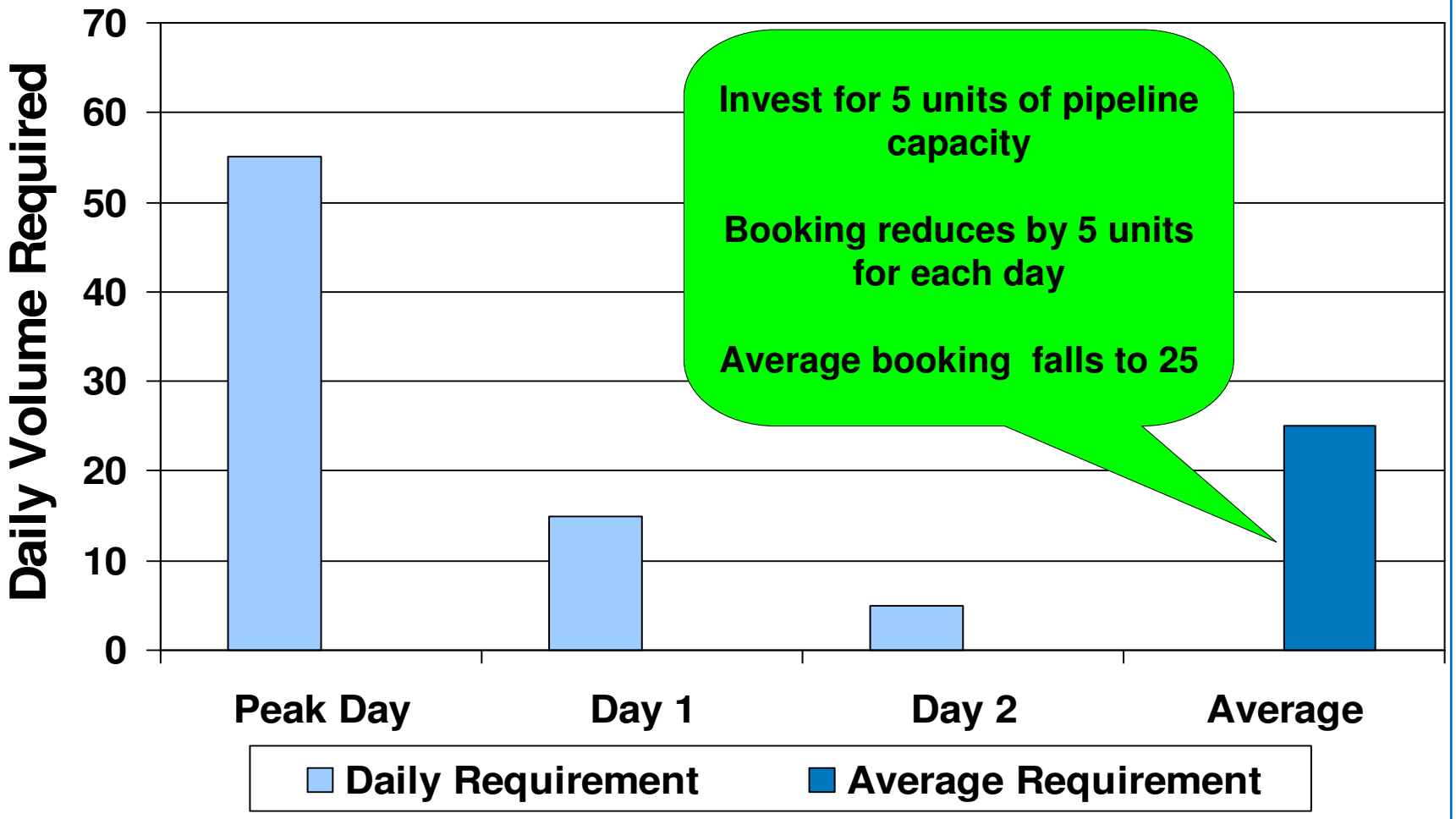
Daily Requirements vs. Average Requirements
Example Booking



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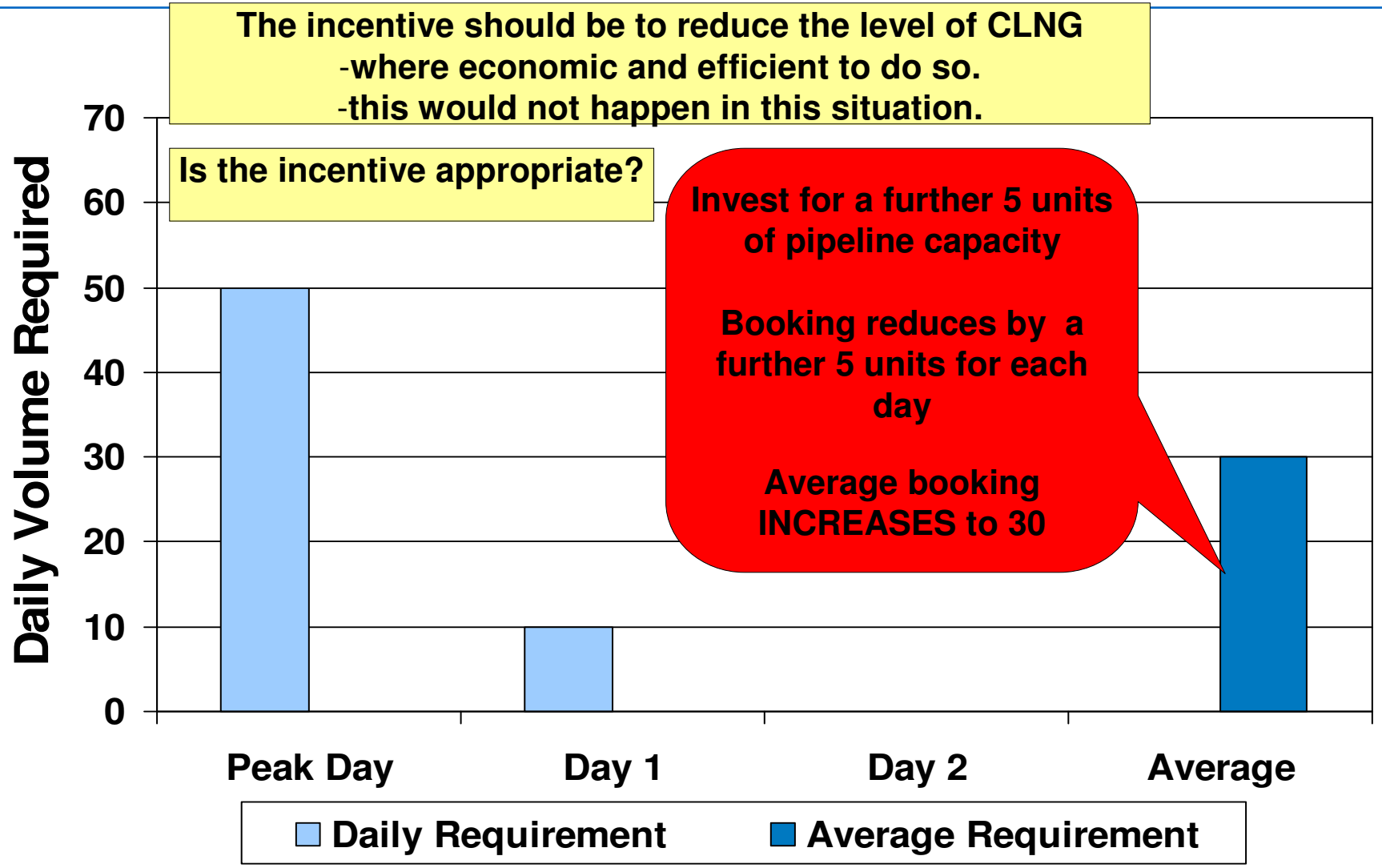
Daily Requirements vs. Average Requirements Example Booking



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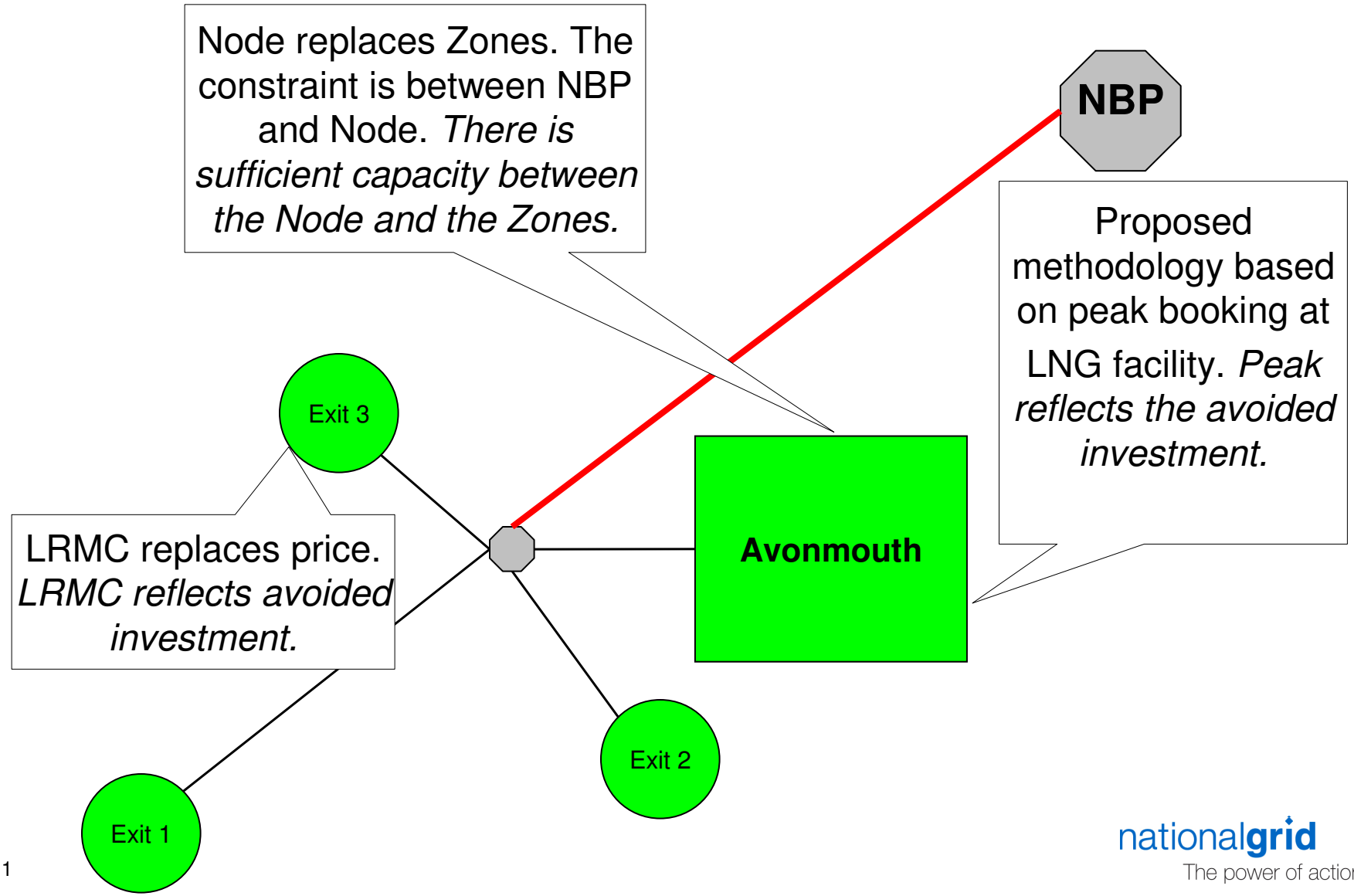
Proposed Methodology



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Proposed Methodology for Consultation

In order to incentivise National Grid to appropriately consider investment in relation to CLNG costs, the credit should be cost reflective of the investment.

Credit should be related to our peak day booking of CLNG.

Credit should be based on LRMC at the CLNG node rather than at the zones the CLNG 'supports'.

- There is already sufficient capacity between the constrained point and the exit zones i.e. we have enough capacity to move peak flows downstream of Avonmouth but not upstream of Avonmouth.

Credit should be based on LRMC of providing exit capacity at the CLNG node rather than the exit charge.

- Exit charges include a revenue adjustment which factors in non asset costs.

This approach better reflects the avoided investment costs resulting from CLNG i.e. avoided investment in exit capacity.

- This is consistent with our Licence charging objectives.

Indicative Effect - Example

CLNG Storage Requirement			Indicative Annual Credit (£m)	
Volume (GWh)	Days	Peak Day (GWh/day)	Prevailing Methodology: Average & Exit Charge & Zonal Cost	Proposed Methodology: Peak only & LRMC & Nodal Cost
90	3	60	£2.9m	£2.9m
75	3	55	£2.5m	£2.7m
60	2	50	£2.9m	£2.4m

Note: indicative CLNG credit using example discussed showing the impact of reducing the requirement by 5 GWh per day at 2008/9 price levels at Avonmouth.

Effect on other Transportation Charges

There will be no change in the level of Transportation charges.

- National Grid has a fixed allowance within its SO incentives with which to procure CLNG. There will be no change in this level and therefore no resulting change in the SO commodity.

Shippers booking the 'bundled' service at CLNG sites will continue to receive a credit related to the requirement for CLNG by National Grid.

- An incentive on National Grid to book an efficient level of CLNG might reduce the level of constraint at the relevant facilities for shippers.
- The actual level of the credit and constraint will be dependent on precise booking requirements but similar to that for this year if the same level of booking is required.
- This proposal should better support the long term incentive to invest where economic and efficient to do so.

Next Steps

Consultation paper on revised methodology for CLNG payments.

- This proposal updates an existing methodology in respect of CLNG entry points.

- Timeline

– Issued for consultation	November 2008.
– Close of consultation	December 2008.
– Final proposals	January 2009.
– Ofgem veto period ends	February 2009.
– CLNG credit to be published	1 March 2009.
– CLNG credits applicable from	1 May 2009.