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26 February 2004

Shippers, Transco and other interested parties

Dear Colleague,

Modification Proposal 0647 – ‘Transitional arrangements to facilitate the change of the Isle of Grain storage facility to a LNG importation facility’

Ofgem has considered the issues raised in this modification proposal and has decided to direct Transco to implement the proposal. In this letter, we explain the background to and nature of the modification proposal, and give our reasons for making this decision.

Background

LNG storage services at the Isle of Grain facility will only be available for part of the 2004/05 storage year. The exact date at which such services will cease to be available will depend on the date of the conversion of the Isle of Grain storage facility into a LNG import terminal¹ but it will not be before 1 January 2005.

The network code will therefore have to be amended to reflect the truncated nature of the Isle of Grain storage service.

The Proposal

For the 2004/5 Storage Year, it is proposed that transitional LNG storage services be made available at the Isle of Grain Storage Facility until the "Effective Date".

It is further proposed that under the transitional storage services procured:

- There would be no carry-over provisions for gas-in-storage with effect from the Effective Date; and

¹ 'National Grid Transco's proposal to transfer its Liquefied Natural Gas facility at Isle of Grain to a separate NGT group company – a consultation document', Ofgem May 2003 and National Grid Transco's proposal to transfer its Liquefied Natural Gas facility at Isle of Grain to a separate NGT group company – a decision document', Ofgem July 2003

- Mandatory withdrawals would apply unless alternative arrangements had been made between the Users concerned and parties that had secured a service at the Isle of Grain LNG Importation Terminal with effect from the Effective Date.

Respondents' Views

Four responses to this proposal were received. Two respondents were against the proposal, one gave it qualified support, while another respondent gave it full support.

One respondent had a number of concerns relating to the way in which the import terminal was intended to operate, especially in relation to the basis on which Transco would continue to access its system support services, and also the impact of the proposal on top-up and security of supply. These concerns had been detailed in this respondent's response to modification proposal 639 – *'Isle of Grain: Change of status from LNG storage facility to importation terminal'*.

This respondent also commented on the potentially negative impact of the *'effective date'* on both shipper participation in the 2004/05 LNG auctions and security of supply. Regarding the latter, it would be helpful if the effective date could be moved to 31 January 2005.

Another respondent commented that the value of 2004/05 storage services at Isle of Grain would be affected by this modification. Additionally, there was the possibility that Transco could make windfall gains from shippers who had gas-in-store immediately prior to the effective date.

Qualified support for the proposal came from one respondent on the basis that services at Isle of Grain were available for the entire 2004/05 storage year.

Full support came from one respondent who commented that the proposal was consistent with facilitating competition between relevant shippers and suppliers as it would ensure that storage services were made available for as long as possible in the run-up to LNG importation. A further comment was that this proposal supported the clear differentiation between Isle of Grain as a storage facility and as an import terminal.

Transco's Views

Transco supports this modification on the basis that it would enable the provision of a storage service at Isle of Grain for as long as possible prior to the commissioning of the import terminal.

Transco points out that storage customers know in advance that the withdrawal of storage services will not be prior to 1 January 2005. Consequently, users would have the opportunity to manage their stock position - should they decide to procure a part-year storage service at Isle of Grain- and avoid becoming distressed sellers of gas.

Users rather than Transco would become the primary beneficiaries of any low OCM prices resulting from storage withdrawals and therefore Transco would not be in the position of making large windfall gains. Reserve prices at Isle of Grain (as contained in the 2004/05 Annual Storage Invitation) would reflect the part-year aspect of the storage service, and this should ensure that Transco's revenue reflected the service provided.

Security of supply would be enhanced as a result of the change of status of Isle of Grain as an importation terminal is associated with the rapid replenishment of stocks held at that location. Deferring the effective date to the end of the 2004/05 Storage Year would therefore reduce the security of supply benefit associated with Isle of Grain's change of status.

Ofgem's Views

Ofgem has previously stated its view that an import terminal could be expected to benefit security of supply.² That remains our view and, in that context, it would be beneficial for the import terminal to become operational as sooner rather than later.

Transco has also informed Ofgem that the conversion of the Isle of Grain from a storage into an importation facility would change the nature of supply from that of peak supply to baseload supply. Consequently, this would have an overall benefit as it would reduce the requirement for top-up at Isle of Grain.

Ofgem does, however, note the concerns expressed by some respondents regarding the commercial impact of the facility's conversion, especially in relation to customers becoming distressed sellers of gas ahead of the effective date. It is, however, difficult to see how this would be the case given that storage customers would already know the timetable for notification of the effective date and that this would not be before 1 January 2005.

Customers should, therefore, be able to value Isle of Grain services accordingly. Moreover, the changes to the Isle of Grain auction reserve price for the forthcoming LNG auctions should result in Transco's revenue reflecting the service provided.

Although both modification proposals 639 and 647 relate to the import terminal at Isle of Grain, they are not actually dependent on each other (639 refers to the basis on which Transco would be able to access transmission support services at the import terminal). Ofgem has issued its decision on modification proposal 647 as this affects the publication of TLNGS' 2004/05 Annual Storage Invitation (in this case, the nature of the Isle of Grain service).

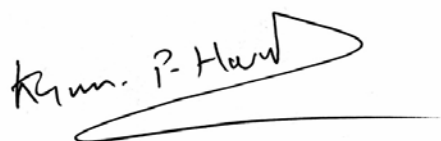
Ofgem's decision regarding this modification proposal should in no way be seen as fettering our decision with respect to modification proposal 639 (this decision will be published in due course).

Ofgem's decision

Ofgem has decided to direct Transco to implement this modification because we believe that it does better facilitate the relevant objectives in Transco's Gas Transporters licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the number indicated above.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Kyran Hanks', with a long horizontal line extending from the end of the signature.

Kyran Hanks
Director, Wholesale Markets

² *National Grid Transco's proposal to transfer its Liquefied Natural Gas facility at Isle of Grain to a separate NGT group company – a decision document*, Ofgem July 2003