

2 and 42% of current charge). We consider this to be a modest to significant range. Ofgem goes on to explain that, when considered in conjunction with the assumed higher capacity charges paid by some shippers post implementation of GCM19, the net change is between a decrease of 0.0081 p/kWh (for those booking long-term) to an increase of 0.0303 p/kWh (those buying on the day at the most expensive entry point). Again, we see this as a positive and worthwhile outcome. There is clear merit in implementing the proposals to achieve the predicted impact on capacity and commodity charges (decrease of 0.0014 p/kWh to increase of 0.0064 p/kWh). Unfortunately, the impact assessment fails to assess the financial consequences of vetoing implementation. The assessment also fails to consider the changes as a first step towards improved system performance rather than as an absolute solution. Implementation of the proposals can only increase the proportion of allowed TO revenue recovered through capacity charges and can therefore only decrease the proportion recovered through the commodity charge. This is an important achievement in its own right, regardless of scale of impact. Furthermore, analysis of data from 2007/08 through to 2009/10 clearly shows that the imbalance between TO capacity and commodity revenue is widening as market participants increasingly rely upon zero-priced short-term capacity. By vetoing the proposals Ofgem will not only fail to stop this escalating trend, but will actually facilitate a worsening of the problem. This aspect seems to have been entirely ignored during the impact assessment.

When the current pricing arrangements were introduced, Ofgem considered there to be “sufficient competition at the majority of large beach terminals in the short-term auctions to avoid significant under-recovery”. The market data collected and presented by National Grid shows categorically that this is not the case and, importantly, that the malfunction of the present arrangements has been compounded year on year. Ofgem state that long-term auctions provide the following important benefits:

- “Bring about substantial improvements to the NTS investment planning process, in combination with the entry capacity incentive;
- Provide reliable indication of demand for entry capacity at different locations on the NTS;
- Provide reliable and robust signals to inform investment decisions;
- Provide increased certainty over entry capacity charges over the long term”

Applying second order logic, it seems reasonable to expect that Ofgem would seize the opportunity to adjust the system to encourage what it has identified as positive behaviour. Data presented by NGG clearly shows that, since 2002, market participants have realised that they can rely upon National Grid’s obligation to release short-term capacity at zero price as a means by which to avoid capacity charges and minimise their costs. There is absolutely no doubt that cross-subsidy is a major feature and flaw of the present system. There is also no doubt that the current pricing arrangements disincentive long-term booking of capacity and that any former correlation between auction behaviour and value placed upon capacity has been completely eradicated.

In summarising your position on implementation of GCM19 Ofgem conclude that the current arrangements ‘allow for a more efficient allocation of capacity’. We simply cannot understand how maintenance of clearly evidenced malfunction can be considered more efficient, especially given the weight of evidence presented on consistent under-recovery of entry capacity changes, prevalence of cross-subsidy, and failure to encourage desired long-term capacity bookings.

UNC285

As the intent of GCM19 would be undermined by the availability of UIOLI capacity at below reserve price, implementation of UNC285 is a necessary complement to the improvements proposed via GCM19. Ofgem consider that UNC285 “could have a negative impact on short-term liquidity in the gas market”. In apparent contradiction, you go on to conclude (p23) that ‘the forward liquidity in the GB wholesale gas market is higher than observed in a number of other gas and commodity markets and is likely to be sufficient for the hedging requirements of the majority of market participants’. Whilst Ofgem believe that “reduced network usage due to restricting access to interruptible users

could also be detrimental to competition” we anticipate that the changes in bidding behaviours facilitated by GCM19 and UNC285 will improve competition in the non-UIOLI sector. We have no reason to believe that availability of interruptible capacity will become an issue. In conclusion, Ofgem consider that “the limited potential benefits from the improvements to the secondary market from UNC285 would be outweighed by the detriment to efficient and economic operation of the NTS”. This statement is erroneous and at odds with majority industry opinion.

Conclusion

In summary, we strongly urge Ofgem to examine the full evidence base available when assessing these proposals and to consequently reverse the initial view that the proposals should be vetoed. Examination of available market data makes clear that the existing pricing arrangements are no longer fit for purpose. In accordance with the majority of industry participants, we believe that these proposals provide a useful first step in addressing the major weaknesses and starting us on the road towards arrangements more consistent with the European model.

Stakeholder Engagement

In addition to expressing our grave concern over the conclusions drawn by Ofgem in this particular impact assessment, we regret the need to consider this publication in a wider context and to raise our considerable dissatisfaction over recent conduct. The stakeholder engagement procedure followed by Ofgem during the three major recent issues (substitution, user commitment and charging) appears to have settled upon the following pattern: i) a weakness is identified in existing arrangements, ii) stakeholders (industry) express an aspiration for improvement through change, iii) industry (in the presence of Ofgem representatives) invests considerable time and resource to determine root cause and to agree a potential solution, iv) a change is formally proposed and the majority of stakeholders respond positively via the associated consultation, v) Ofgem rejects the proposal having failed to express this firm opinion during the preceding months/years of discussion and offering no suggested alternative.

Under a good working relationship, this end point should rarely, if ever, arise. Regular communication/feedback and a willingness to offer an alternative solution mitigate very effectively against it. We are extremely frustrated that Ofgem appear to have accepted this pattern of behaviour as standard practice. We suggest that a full and frank discussion with industry is needed as a matter of urgency to draw a line under this period and to agree future improvements.

As always, we are very happy to discuss any aspect of this submission.

Yours sincerely

(by email)

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