Pamela Taylor
Ofgem
9 Millbank
London SW1P 3GE

19 December 2012

Dear Pamela

Re: Open letter: Call for evidence on the use of the gas interconnectors on Great Britain's (GB's) borders and on possible barriers to trade

Introduction

Gazprom Market & Trading (GMT) welcomes the opportunity to respond to the call for evidence. Like Interconnector UK (IUK) we have carried out our own analysis to compare and contrast with the outputs published by the regulators. Our analysis is based on the day-ahead price index provided by Argus – an index which is regularly used by the trading community to assess market conditions and underpin contractual arrangements.[1] We note that the Bloomberg index used by the regulators is a less reliable indicator and therefore, rarely, if ever employed by market participants.

The outputs from our analysis are very similar to those reproduced by IUK in its presentation at the industry meeting held on the 21 November and as a result we do not agree with the observation that the interconnectors are operating in an inefficient manner.

On this basis, GMT requests that the investigation is brought to an early conclusion with a recommendation that no further regulatory intervention is necessary.

GMT analysis

Interconnector UK

As stated in the introduction GMT employed the Argus day-ahead indices for Zeebrugge and NBP as the basis for determining the relative price differentials between the two markets. The analysis was carried out over a five year period between 2008 and 2012 inclusive. Consistent with the studies carried out by both the regulators and IUK, GMT compared actual flows with the day-ahead price indices to determine the efficiency of flow[2]. Finally, transportation costs related to direction of travel were estimated as follows:

- Zeebrugge to NBP @2p/therm – this includes variable costs associated with shipping gas across the interconnector and entering it into the NTS.

[1] I(UK) analysis is based on the Heren index, which again is commonly used by the trading community

[2] Efficiency of flow meaning the market responsiveness of flows with an expectation that they will be in the direction of the highest priced market.

- NBP to Zeebrugge @1.5p/therm -- this includes variable costs associated with shipping gas across the interconnector and exiting it from the NTS

The results are presented in Annex 1

The most striking observation is that the price differential rarely went outside of the -1.5p/th to +2p/th range meaning that commercial driver to flow physical gas between the markets has been low. This would go a long way to explain why flows have rarely matched full capacity levels.

Furthermore, the gradient of the slopes of the clusters are fairly consistent and reflective of a high degree of commercial efficiency i.e the higher the price differential, the greater the level of recorded flow.

Finally, it is clear that there is a bias towards UK exports, with a concentration of data points above the x-axis in each of the years examined. This can be explained by the level of NGG entry related commodity charges which in turn incentivise shippers to take advantage of short-haul charges and bypass the NTS.

BBL

As with the IUK analysis, GMT employed the Argus day ahead indices for TTF and NBP as the basis for determining the relative price differentials between the two markets. The analysis was carried out over a five year period between 2008 and 2012 inclusive. Consistent with the studies carried out by the regulators, GMT compared actual flows with the day-ahead price indices to determine the efficiency of flow[3]. Finally, transportation costs related to direction of travel were estimated as follows:

- TTF to NBP @1.9p/therm – this includes variable costs associated with shipping gas across the interconnector and entering it into the NTS.
- NBP to TTF @1.9p/therm -- this includes variable costs associated with shipping gas across the interconnector and exiting it from the NTS

The results are presented in Annex 2.

Unlike the flow analysis presented for IUK, the results are less clear as the data points are less correlated. It should be noted, however, that in common with the IUK analysis the spreads tend to sit within the transportation cost boundaries i.e. within -1.9p/th to +1.9p/th. The lack of correlation and the various outliers can be explained by the fact that flows are, to some degree, determined by the physical balancing needs of the local Dutch network.

Furthermore, beyond the fact that flows do occur within the transportation costs envelope, it is evident that spreads have become tighter. Certainly, the spreads shown for 2011 and 2012 are generally narrower than those for previous periods. This would imply that NBP and TTF are becoming more closely linked, we would assume partly as a result of the physical linking of the markets and the subsequent growth in liquidity at the TTF hub. Certainly, GMT would argue that the reduction in spreads between the two markets should be hailed as a reflection of the fact that liberalisation, certainly in NW European gas markets has made excellent progress.

Conclusions

From the independent analyses carried out by IUK and GMT, is it clear that the interconnectors are operating very efficiently. Importantly, by the very fact that the spreads between the various markets

[3] Note that in this instance, physical flow is uni-directional across BBL, that is from TTF to NBP.

either side of the interconnectors are generally small; rarely exceeding the costs of transportation, this suggests that the physical interconnections have created interlinked markets consistent with the aims of the Gas Target Model.

The contractual arrangements underpinning the operation of the interconnectors have shown to be appropriate to enable; a) investment in the pipelines; b) provision of effective transportation arrangements; and c) market efficient operation.

GMT is not aware that any third parties have raised concerns with the regulators concerning the operation of the interconnectors and suggest that investigations such as this should only be carried out when there is tangible evidence from market participants that the operation of a market is being stymied.

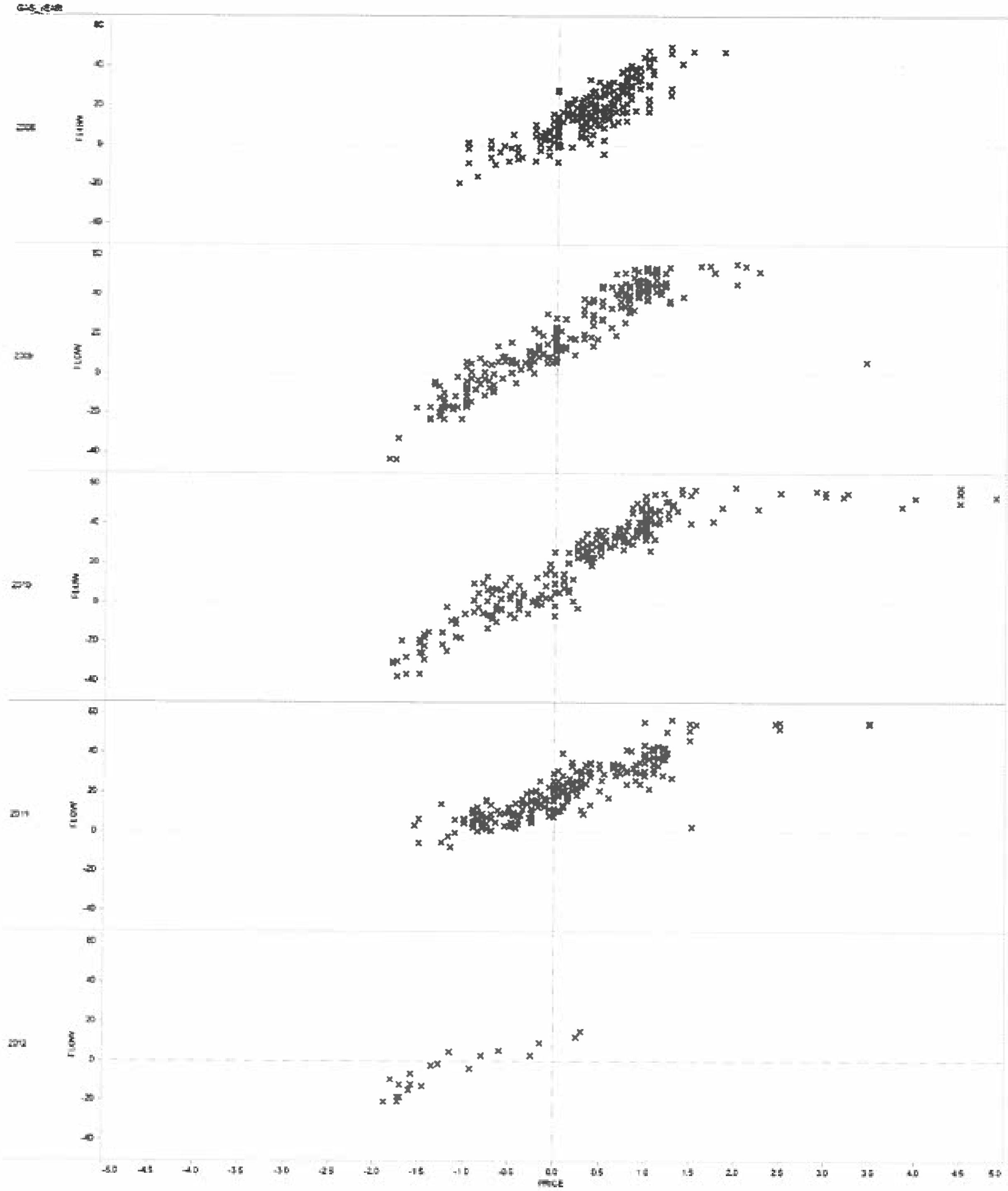
GMT sees absolutely no justification for further regulatory intervention, beyond that which is already legislated through the Third Package. Indeed GMT would view further intervention, along the lines suggested by the regulators as counterproductive potentially creating disincentives for merchant investments. As the regulators will be well aware, excessive regulatory intervention/uncertainty is a major barrier to investment in long term assets.

Finally, GMT would be happy to share the details of our analysis if this would be helpful to the investigation.

Yours sincerely

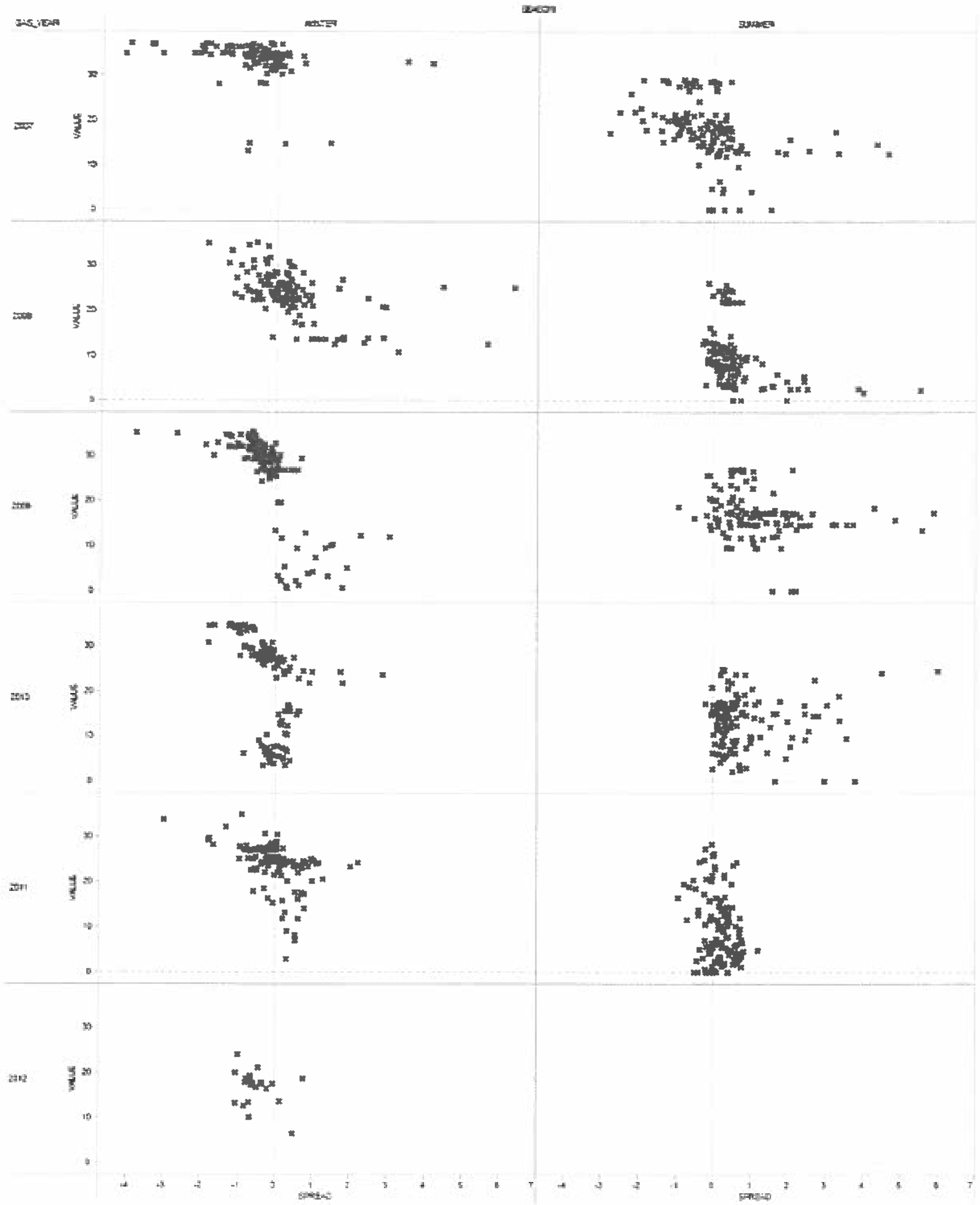
Fiona Strachan
Regulatory Affairs Manager

Annex 1 – IUK flows – NBP/Zee day-ahead spreads



Note: Positive Spread = Zee>NBP

Annex 2 – BBL flows – NBP/TTF day-ahead spreads



Note: Positive Spread = TTF>NBP

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