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Dear Arina,

National Grid Gas response to the open letter: Call for evidence on the use of the gas interconnectors on GB's borders and on the possible barriers to trade.

We welcome the opportunity to respond to this consultation and would like to thank Ofgem, CREG and the NMA for the work carried out in producing the open letter and the underlying analysis upon which it is based.

National Grid, through National Grid Gas plc ("NGG"), owns and operates the gas transmission system in mainland Great Britain and four of the eight GB gas distribution networks. We are submitting this response on behalf of NGG in our capacity as a TSO.

NGG read with interest the analysis and the conclusions contained within the open letter. The open letter concentrates upon flows across the IUK and BBL interconnectors which may be perceived to be inefficient, i.e. "flows against price differentials". We note that the analysis of flows and price differentials are based on different time periods. Specifically, the analysis seeks to explain the end of day actual flows by reference to average Day Ahead prices (as provided by Bloomberg). Some of the apparent flows against price differentials may be explained by changes in the price signals from the day ahead to within day. We also note that some stakeholders attending the Ofgem workshop on this topic in November presented a view of some of the analysis using Heron day ahead price data rather than Bloomberg, which showed far fewer flows against price differentials and a tighter price spread, particularly between Bacton and Zeebrugge. We would also highlight that no analysis has been published regarding flows across the Dutch / Belgian border and it is possible that congestion, or other capacity access issues on this border, could be driving some market participants to route gas via Bacton. Before proceeding to any recommendations arising from this consultation the NRAs should carry out further analysis and satisfy themselves that there are no issues with these interconnection points.

Whilst noting the above issues, NGG believes that there is still value in examining the behaviour of shippers on the GB interconnectors and we are very happy to assist the NRAs in building a full and transparent picture of markets in this regard. For the most part, we believe that the call for evidence is aimed at gas shippers and traders and that these parties are best placed to provide details of the strategy behind their actions. For our part, we have sought to provide comments on those issues upon

which we have a direct influence, i.e. the availability of Entry and Exit capacity at Bacton and the potential effects of the GB transmission charging arrangements.

The system access and charging arrangements at all points in the chain will have an impact upon the decisions that shippers and traders make about moving gas from one market to another. Regarding capacity availability, NGG's arrangements at Bacton enable our customers to obtain entry and exit capacity across a full range of products in various timescales. Our capacity baseline arrangements ensure that the full technical capability of our network in the Bacton area is marketed every day and the commercial incentives that we have in place provide a mechanism for NGG to release additional, non-obligated, capacity where there is sufficient market demand and conditions within the network allow this. We are also required, under the UNC, to make available Interruptible NTS entry Capacity and Off-peak NTS Exit Capacity. Current baselines and long term booked capacity are shown below (Figures shown for Jan 2013):

	Technically Available (Baseline Capacity)	Capacity Sold Long Term	Capacity Available for Short Term Sales
Bacton ASEP (Entry) kWh/d	1,783,400,000	1,116,620,605	666,779,395
Bacton IUK (Exit) kWh/d	623,580,000	558,605,519	64,974,481

Throughout 2012 the average Firm entry capacity that has gone unsold has been 471,952,989 kWh/d. The full picture for Entry Capacity at the Bacton ASEP, throughout the period studied for the open letter, is shown graphically in appendix 1 to this response. It would appear from the data shown that since quantities of short term capacities are generally available, the access to entry or exit capacity from NGG at Bacton is unlikely to be a barrier to flows in either direction. Indeed to further confirm this point NGG have not needed to engage in any buy-back or scale back of capacity during the past 3 years at Bacton.

With regard to system charges, there are really two charging elements that are relevant here, these being capacity and commodity charges. For all ASEPs, including Bacton, shippers pay for entry capacity at the price at which entry capacity is allocated in the relevant auction. For short-term auctions the reserve price is subject to a discount and is set at zero for within-day capacity sales. In recent years this has led to a significant shift away from long-term capacity bookings towards short-term (generally free) capacity at many ASEPs (this is clearly illustrated in the graph in appendix 1). Whilst this may have resulted in some benefits in terms of liquidity on the within-day gas commodity markets, at the NBP, it has also led to a significant under-recovery of capacity revenue via capacity charges for NGG. Currently, this under recovery of capacity revenue is mitigated via a TO entry commodity charge. In recent years, an increasing proportion of the TO target entry revenue has been collected via the commodity charge rather than via capacity charges. The proportion has increased from an anticipated 90:10 (capacity:commodity) to 30:70. The commodity charge is payable on every unit of gas transported to the NBP and therefore it could be argued that excessively high commodity charges act as a disincentive to importing gas into GB. It is likely to affect the decision to trade on the day irrespective of whether capacity had been bought in advance or on the day. The current TO entry commodity charge is 0.0229p/kWh. There is also an SO commodity charge applicable to entry flows and this is currently 0.0331p/kWh which aims to recover variable, non-location specific costs associated with System Operation.

There is an alternative lower commodity charge available for gas transported over a shorter distance. Shippers who nominate exit flows from points close to nominated entry flows can avoid paying all standard commodity charges by opting to use the discounted optional commodity charge – commonly referred to as the short-haul tariff. This discounted tariff was introduced some 15 years ago as a way of avoiding the perverse incentive that could exist to build dedicated transmission pipelines that run parallel to the NTS as a means of avoiding NTS charges. The current short-haul charge for flows from the Bacton ASEP to the exit point at IUK, is 0.0006p/kWh. Whilst this objective (of avoiding the perverse incentive for inefficient bypass) remains, it is possible that the combined effects of the high commodity charges and the option of the short-haul charge may mean that, on occasions, it could be less expensive to send gas landed at Bacton (either from BBL or other sub-terminals) to Zeebrugge, via IUK, than to the NBP. The precise flow decision will depend on a number of factors but in NGG's view one of these factors will be charges across the IUK interconnector and entry charges at Zeebrugge.

The issue of commodity charging is currently being debated in connection with the anticipated EU Network Code on Harmonised Transmission Tariff structures for Gas.

Regarding the specific questions posed in the open letter, as highlighted above, NGG is not best placed to comment on the efficiency of cross border trading nor do we have direct experience of such trades. Regarding potential improvements to the current market arrangements, we believe that the question should be set in the context of the current pan European efforts to develop network codes, particularly in the areas of Congestion Management Principles, Capacity Allocation Mechanism and Tariff arrangements. The aim of these mandatory codes is to provide better coordinated access to capacity across the EU and to lead to a better functioning internal market for gas.

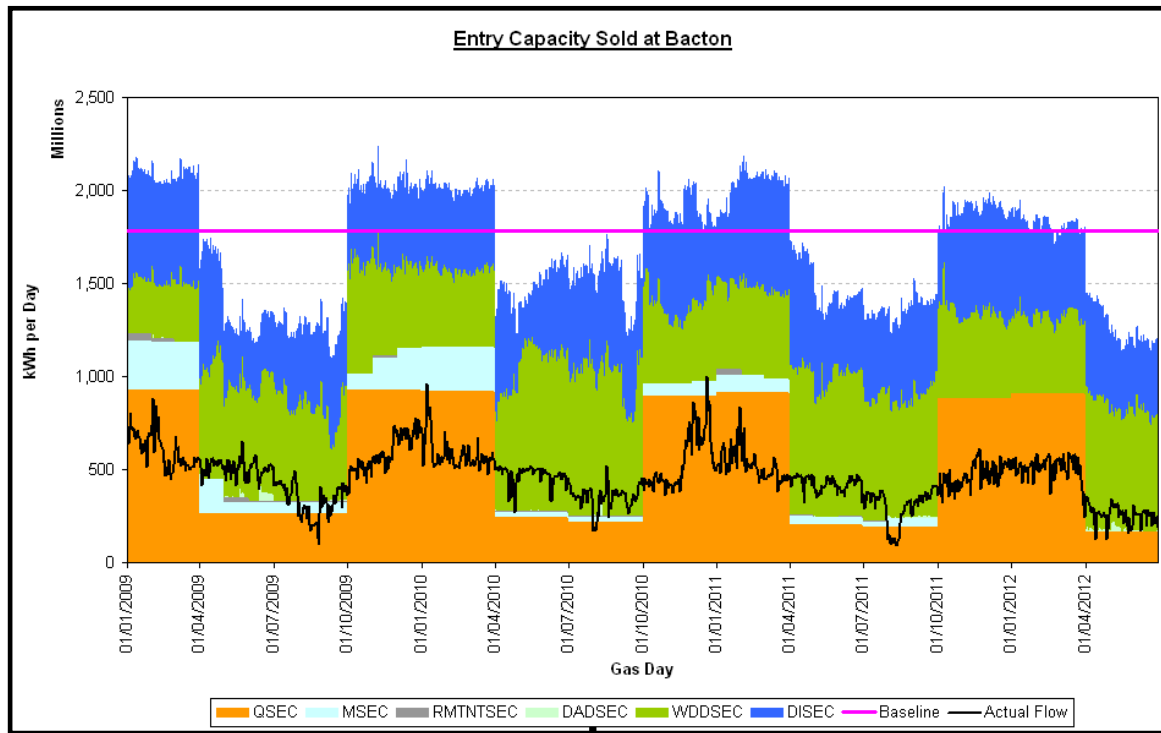
Many of the apparent problems that the open letter points to are the same issues that the European codes are also seeking to solve through the mandatory process. Given this fact, and having regard to the considerable resources that are currently deployed by all parties (including ourselves, other TSOs, NRAs and other stakeholders) we believe that the any additional measures need to be very carefully considered and have a robust, positive impact assessment before significant work is undertaken. That said, a review of the effects of the GB charging arrangements with regard to cross border flows and security of supply for GB might be a useful area to focus upon.

If any further assistance is require from National Grid then please do not hesitate to ask.

Yours sincerely,

Chris Logue

Appendix 1 – Entry capacity sales at Bacton ASEP



Capacity sold at the Bacton ASEP (Aggregated System Entry Point) between 1st January 2009 and 30th June 2012.

- QSEC: Quarterly System Entry Capacity (FIRM)
- MSEC: Monthly System Entry Capacity (FIRM)
- RMTNTSEC: Rolling Monthly Transfer and Trade System Entry Capacity (FIRM)
- DADSEC: Day Ahead Daily System Entry Capacity (FIRM)
- WDDSEC: Within Day Daily System Entry Capacity (FIRM)
- DISEC: Daily Interruptible System Entry Capacity