

Pricing issues for the mature regime

DISG - 22 March 2005

Richard Court

Commercial Frameworks Manager

Overview

- Intention to publish three pricing consultations preceded by three pricing discussion papers:
 - NTS Exit Flat Capacity Pricing
 - NTS SO and TO Exit Commodity Charging
 - NTS Exit Flexibility Capacity and Commodity Charging
- Summary of commodity and flexibility discussion questions
- Summary of NTS Exit Flat Capacity pricing issues and discussion of Illustrative UCAs

NTS Exit Flat Capacity Pricing

- PD18 will discuss issues raised at ERF in December/January
- Use of LRMC based UCAs as basis for nodal reserve prices?
- Pricing of baseline and incremental capacity?
- Indicated potential for significant change

NTS Exit TO and SO Commodity Charging

- PD19 will discuss issues raised at ERF in December/January
- TO exit commodity charge as exit revenue recovery mechanism?
- Common entry/exit commodity charge as TO revenue recovery mechanism?
- NTS TO exit commodity charge levied on NTS direct connects/DNOs or shippers?
- NTS SO commodity charge symmetry - levied on NTS direct connects/DNOs or shippers?

NTS Exit Flexibility Charging

- PD20 will discuss issues raised at ERF in December/January
- Pricing of baseline and incremental capacity?
- Principle of flexibility commodity charge?
- Level of flexibility commodity charge?

LRMC/Administered Price divergence and Illustrative UCAs

LRMC/Administered Price Divergence (1)

- PC76 (December 2002) noted significant variation between prices and Long Run Marginal Costs (LRMCs) but concluded that prices should not be re-balanced until exit reform
- No re-balancing of exit prices with LRMCs since 2002, and this was constrained to +/-30% (PC71)
- Exit price re-balancing also capped in previous years, with underlying variation from UCAs discussed (e.g. PD11 - July 2000)

LRMC/Administered Price Divergence (2)

- Price capping has always been a part of the approved methodology since inception in 1994
- LRMCs have changed as the network and the supply and demand balance evolves, however capping has allowed significant divergence from latest LRMC to develop over a number of years
- Changing supply and demand:
 - Declining flows at St. Fergus, Teesside, Theddlethorpe and Barrow
 - Increasing flows from Bacton, Isle of Grain, Easington and Rough
 - Milford Haven expected from 2007/8 (affects 2008 UCA estimates)
 - New power stations

UCA Calculation Assumptions

- Ofgem incentive consultation suggests UCAs calculated in similar manner to current NTS Entry Capacity regime
 - Long Run Marginal Cost (LRMC) methodology
 - Based on 2005 base network
 - 6 mcm/d increment size
 - Solved without constraining balance between entry and exit
 - No scaling for TO allowed revenue
- New exit nodal UCAs would reflect latest LRMCs

Illustrative entry type UCA/LRMC values

	Illustrative range of LRMC (p/pdkwh/day)	
	Min	Max
East of England	0.0002	0.0041
London	0.0015	0.0191
North of England	0.0002	0.0104
North West	0.0049	0.0219
Scotland	0.0067	0.0237
South of England	0.0030	0.0342
Wales and West	0.0016	0.0579
West Midlands	0.0014	0.0065
Direct Connects	0.0002	0.0221

Further detail including nodal LRMCs will be published in the pricing discussion papers

Comparison against existing exit prices

	Illustrative range of increase (p/pdkwh/day)	
	Max	Min
East of England	0.001	-0.010
London	0.000	-0.011
North of England	0.010	-0.002
North West	0.015	-0.002
Scotland	0.023	0.006
South of England	0.016	-0.008
Wales and West	0.030	-0.015
West Midlands	0.000	-0.006
Direct Connects	0.010	-0.017

Average current exit price is 0.0059 (flat)
0.0077 (weighted)

Pricing Questions (1) ?

- Should exit follow entry -should reserve prices be set to equal UCA?
 - Large winners and losers
- Is there a case for de-coupling reserve prices from UCA?
 - Install a constraint on any effective charge change?
 - Transition to change in 2007 to align with an entry price update?
- How much alignment is needed with entry auction pricing
 - Use 6mcm increment ?
 - Revenue split targeting (e.g. 50% entry / 50% exit)?

Pricing Questions (2) ?

- Pricing of Daily NTS exit flat capacity and interruptible NTS exit flat capacity at day ahead?
- Incremental pricing based on entry model?
- Removal of interruptible transportation credits?
- Removal of constrained LNG credits?

Next Steps on discussion papers?

- Pricing discussion paper (4 weeks) **Mar - April**
- Formal pricing consultation (4 weeks) **Early May**
- NGT submit proposal to Ofgem **Mid June**
- Ofgem approval **July**
- Issue reserve price notice to the industry **End July**
- Exit capacity long term auction **Sept**
- Timetable incorporates shortened notice period which would require Authority direction

Alternatively, NGT can request shortened pricing consultation
e.g. 2 weeks

Pricing issues for the mature regime

DISG - 22 March 2005

Richard Court

Charging and Forecasting Manager