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Dear Sonia

Impact Assessment on P194. Response of INEOS Chlor Limited

I have pleasure in enclosing Ineos Chlor's response to the Impact Assessment on P194.

Yours sincerely



Mark Fitchett
Electricity Purchasing Manager
Ineos Chlor Limited

BSC modification proposal P194

‘Revised Derivation of the Main Energy Imbalance Price’

Response by Ineos Chlor Limited

Introduction

Ineos Chlor Limited, based in Runcorn, Cheshire, is a producer of commodity inorganic and organic chemicals. We are, by far, the largest producer in the UK (and a leading European producer) of chlor-alkali products and chlorinated hydrocarbons. The chlor-alkali process involves the electrolysis of brine, and our operations account for about 1% of the national electricity demand. Electricity represents over 70% of the variable production cost in this process. The downstream operations are also very energy intensive, with a significant demand for both natural gas and steam.

The company produces basic commodity chemicals where, in general, there is no scope for product differentiation. The business is subject to global competition from the EU, the US Gulf, and increasingly, from the Middle East and Asia. The business is already operating on very thin margins, and because of the highly competitive market, we have no capability to pass increases in energy prices on to our customers.

As a result of the introduction of NETA, INEOS Chlor operates an energy account and is obliged to trade electricity to balance consumption and purchase on a half-hourly basis. Imbalance costs are directly for our own account.

Summary

We do not believe P194 will achieve the stated aim of improving incentives to balance.

We believe that there is a significant risk that the modification will have the opposite effect and increase average imbalance

We believe the modifications will force many participants (ourselves included) to adopt positions where they enter real time significantly long to avoid risk of being short.

Participants will be asked to respond to short-term market signals without the information, tools or market access to do this efficiently.

Conversely, the modification will reduce the role of the residual balancer at times of system stress, but increase it at other times as NGC will need to sell energy on the balancing mechanism.

We believe that the fundamental problem with the electricity market is low liquidity. We are concerned P194 could make this worse.

Detail on the arguments behind this summary are given below.

Is there incentive to balance and does this need to be increased?

This is a very simple answer. We have a large incentive to balance, and will not be able to improve if the penalties for being out of balance are increased – we will simply be penalized to a greater extent for the same imbalance. We cannot see how a sensible solution to the problems in the electricity market is to introduce modifications that increase the risk of participating in the market.

We are concerned that P194 takes the “large stick” approach to encouraging parties to balance, without any sensible assessment as to whether a large stick is what is required. Given the almost overwhelming opposition to P194 within the industry it would be sensible to question whether difficulties in balancing are a result of the penalties from imbalance being too low.

In our experience this is absolutely not the case.

What are the barriers to efficient balancing

Our experience suggests that P194 may actually make it more difficult for parties to adjust their contracted positions at times of market stress. We believe the fundamental problems in the electricity market are a real and significant barrier to efficient operation of the market, and hence efficient balancing.

To our knowledge one of the most significant problems facing all participants is a lack of liquidity in the forward and prompt electricity markets.

This gives rise to no price discovery. Price discovery is key to managing a position, and without it participants are sailing blind. Worse, our experience is that the worst time for price discovery and liquidity is at times of system stress. We have experience of

- No prices being offered or bid
- Massive spreads (particularly at times of stress) which mean that prices offered are nonsensical.
- Difficulty in transacting even moderate amounts of power

We do not face these problems because we are a small player as we transact through a major player in the traded electricity market and we do not experience restricted access through credit issues. We are aware that this is a further (and very significant) constraint on many market participants.

The result of this is that at certain times (and almost invariably at times of market stress) we have found it impossible to adjust our contracted position in any sensible way.

The problems with balancing within the electricity market do not relate to incentives to balance. We can confirm that these incentives are large and do not need increasing.

We believe there are fundamental issues with access to market and market liquidity that prevent parties from adjusting positions.

What will the impact of P194 be?

We believe that the only impact of P194 will be that parties will deliberately overbuy or undersell power such that overall the net length of the market will increase.

This is easily understood.

- Imbalance information is not available in real time, it is slightly delayed
- Imbalance prices can only inform buying decisions 2 hours + from the time they are published. Our experience is that this window is more realistically 3 hours.
- Thus a high imbalance price can only inform buying decisions 3 hours hence. At that time the cause of the high prices may have passed. Parties will not respond to high imbalance prices.

The only response to P194 can be to the *threat* of high imbalance prices, and the obvious response is to increase the length of all participants.

Quite perversely this could reduce the liquidity of the prompt electricity markets, as parties will already be carrying “cover” for small shortfalls, and in some cases unwilling to adjust positions to avoid risk.

NGC’s role as residual balancer will therefore increase as NGC will be frequently balancing the system through the sale of energy. This cannot be a desirable outcome.

P194 will result in higher costs because of the increased balancing actions and the penal imbalance prices. These costs WILL be passed to end users with no benefit to these users.