



Stuart Cook
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Ofgem
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29th July 2009

Dear Stuart

Gazprom Marketing & Trading Response to “Informal Consultation on National Grid Gas’ NTS Gas Transporter licence condition with respect to Entry Capacity Substitution”

Thank you for the opportunity to respond to the above consultation. I would also like to make some comments on your open letter dated 3rd July 2009, on the subject of development of an Entry Capacity Substitution Methodology.

Gazprom Marketing & Trading Limited (“GM&T”) supports the proposed Licence drafting as a suitable way of solving the problems highlighted by the Substitution workshops held in the first half of last year. As you will recall, National Grid (“NG”) appeared to be interpreting the current licence drafting in a particularly rigid way, so that, whenever an appropriate signal was received in the QSEC auctions, NG would have to substitute all available un-booked capacity at potential donor ASEPs to meet that signal. This would occur even if there were high levels of capacity destruction at the donor ASEPs due to unfavourable capacity exchange rates, or where there was an obvious future requirement for the capacity at the donor ASEP, even if capacity had not been booked at that ASEP. The latter example highlights one of the risks of substitution, namely that it concentrates the need to book capacity in the one QSEC where there might be substitution, even if this does not match the ability of other market players, who may have legitimate future requirements, to book capacity at that auction. The proposed new drafting should give NG the ability to take such factors into account, and is therefore to be welcomed. It would be helpful if NG could confirm that is their view of the new drafting, so that the industry can avoid the types of problems we encountered last year.

Turning to your letter of 3rd July, and the subsequent discussion at the Substitution Workshop, I would like to make a few comments. In the proposed Licence drafting you have added the following:

“. . . Whilst taking account of reasonable and foreseeable future demands for entry capacity” (Paragraph 10 (c) (iii))

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However in your letter you state that it is not appropriate to use forecast flows as a means of rationing unsold capacity. If the proposed Licence drafting is to have any real meaning, NG will need to use forecast flows to determine “reasonable and foreseeable future demands for entry capacity.” Otherwise it is not clear how NG can use the new drafting to make sensible judgements about the different demands for future entry capacity. For the same reason that we welcome your pragmatic licence drafting, we are disappointed by your letter of 3rd July, and by your comments in the Substitution Workshop of 7th July with regards to the use of forecast data. Furthermore your concerns about the use of the Transporting Britain’s Energy process as a means of understanding potential future demand for capacity need not be realised. It is not beyond the wit of NG to use other forecasts, such as those provided by consultancies, to act as a double check on TBE data. In any case it would be an unwise shipper who chose to cross Ofgem on such a sensitive topic by deliberately gaming TBE input data.

There appears to be a misunderstanding in your letter as to how Substitution will impact capacity availability at the various auctions. One of the weaknesses of Ofgem’s proposed approach on Substitution is that it effectively equates User Commitment with the ability to book capacity in the QSEC auctions only. It is not the case that shippers will be able to buy capacity by making a financial commitment in “a series of auctions that are held every year”, as they can now. In any substitution regime, because it reacts to signals in the QSEC auctions, it has the effect of restricting the decision making period for booking capacity to the relevant QSEC. NG has explained that it is entirely plausible that all potentially substitutable capacity will be used to meet incremental capacity demand in one particular QSEC. In such a case substitution would act as a one off “big bang” effect, after which all projects would have to wait at least 42 months for capacity to be made available to replace that substituted. Even if this is not the case, any capacity that is substituted will by definition be unavailable in the AMSEC, RMTTSEC or other auctions¹.

You place great importance on the notion of User Commitment, and seem to imply that such User Commitment is lacking if not made in the long term QSEC auctions². (“If users want financially firm rights to use the system they need to purchase them and make a financial commitment to pay for them.”) Shippers make financially binding commitments in all the auctions. The key determinants of such commitments are approved by Ofgem, namely the structure of baselines and the pricing arrangements for capacity auctions. To argue that the measure of User commitment is the ability to book capacity (or indeed buy an “option”) in the QSECs alone, as you have done, is misleading.

Lastly we fundamentally disagree with your view that “The introduction of the substitution regime does not change these choices or risks in a fundamental way.” By focusing the effective decision making period on the QSECs alone it clearly does alter the choices. Furthermore the calculations needed to be made

¹ Currently 10% of capacity is also held back for the shorter term auctions, but Ofgem has made clear its intention to remove the 10% holdback.

² As already noted, the nature of any substitution regime means that, if shippers do not bid in the QSEC auctions, they will not have the opportunity to bid for capacity in the AMSEC or RMTTSEC auctions.

to determine likely availability of capacity at future auctions also change. Indeed you acknowledge as much by adding “substitution may broaden the pool of parties who might bid for and secure capacity at a particular entry point and increase the risk that a shippers who has not chosen to buy capacity is unable to access entry capacity on the day.” However, as noted above, it is not only those who try to buy capacity on the day who will be prevented from doing so by the effects of Substitution, but also those who try to buy capacity in the AMSEC and RMTTSEC auctions. In addition you underplay the complexity of the new regime. Shippers will have no idea when participating in QSEC auctions which ASEPs will be most likely to become donors, or how much capacity they may lose as donor ASEPs since they cannot know in advance the exact “merit order” of donor ASEPs or the exchange rates that NG will apply. As NG has explained in the workshops, this will depend on the combination of different capacity bids at different ASEPs, so there are a multitude of potential outcomes³. It is not simply the case that the pool of potential bidders may be broadened, but also that the impact of those bidders can vary widely. This contrasts to the current situation where a shipper bidding at an ASEP only needs to have a view of the likely demand for capacity at that single ASEP, and the level of capacity available at that ASEP. By any reasonable standard this does represent a fundamental change from the current regime.

None of these issues were clear during the last Transmission Price Control Review, and only became so during the various discussions held to develop a Substitution Mechanism. For example, the problems with the Licence drafting only became apparent in the workshops held last year. We support the aim of Substitution to prevent unnecessary investment by NG NTS in the network by ensuring the best use of existing entry capacity capability. However we remain concerned that, by effectively ruling out two of the potential approaches at such a late stage, Ofgem and NG are preventing a full consideration of the trade offs involved in a mechanism as potentially complex as Substitution. For this reason I would urge you to include all three approaches in Ofgem’s forthcoming Impact Assessment.

I hope the above comments are useful. If you have any queries please do not hesitate to contact me on ++ 44 20 8614 3036 or at alex.barnes@gazprom-mt.com.

Yours sincerely,

Alex Barnes

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³ It is interesting to note that Ofgem itself has recognised the uncertainty inherent in ex-post exchange rates, whilst acknowledging that the nature of the network calculations mean that ex ante exchange rates are difficult to achieve in practice. See Letter from Steve Smith, dated 22nd April 2008, on the Entry Capacity Transfer and Trade Statement.

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