

FAO: Graham Knowles

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Dear Graham,

Pricing benchmarks in gas and electricity markets – a call for evidence

National Grid welcomes the opportunity to respond to Ofgem's call for evidence on pricing benchmarks within the gas and electricity markets. This response is on behalf of National Grid Gas plc and National Grid Electricity Transmission plc ("National Grid") and is not confidential.

Background

National Grid owns and operates the high voltage electricity transmission systems in England and Wales and operates the Scottish high voltage system. National Grid also owns and operates the gas transmission system throughout Great Britain and, through its low pressure gas distribution business, distributes gas in the heart of England to approximately eleven million businesses, schools and homes. In addition, National Grid owns and operates substantial electricity and gas assets in the US, operating in the states of New England and New York.

Question responses

Q1: Do you agree with our assessment of the issues?

As expanded on below, we utilise information from Price Reporting Agencies (PRAs) for a variety of reasons. What is vital is that the robustness and trust in these benchmarks is maintained so that competition and liquidity in wholesale markets continues and that pricing benchmarks can be reliably used in commercial clauses. We therefore welcome a review of the methodology and associated transparency involved in the creation of pricing benchmarks. This in tandem with the enhanced scrutiny that REMIT legislation sets out should help maintain trust in the use of pricing benchmarks for commercial use.

Q2: What is your company's policy on providing information to price reporters or other price benchmarking services?

The current policy of our UK Transmission businesses is not to provide information to price reporters. Our unique market position as System Operators of the gas and electricity systems, combined with the minimal volumes that we trade, means that historically we have not been viewed as an appropriate candidate for reporting prices.

Q3: In what ways do you use benchmark prices provided by price reporting agencies or other price benchmarking services?

As the Gas System Operator we currently utilise both gas and electricity benchmark prices as a direct input into the calculations for our gas shrinkage cost incentive, for which we spend in excess of £100m per annum. The precise methodology can be found within our NTS gas transporter licence¹.

Within our capacity as the National Electricity Transmission System Operator (NETSO), price benchmarks are used widely to set incentive scheme targets. Within our Balancing Service Incentive Scheme (BSIS) models, price benchmarks for gas, coal, oil, carbon, and electricity prices are used at a variety of resolutions. These benchmarks feed into cost target models for the majority of the cost categories which combined, annually exceed £800m.. The precise methodologies can be found on our website².

Price benchmarks are used as part of the calculation of payment rates for provision of mandatory balancing services such as frequency response energy payments and reactive power payments. These are defined within the Electricity Transmission Connection and Use of System Code (CUSC).

We also use pricing benchmarks in various bi-lateral contracts for managing both our gas and electricity system operation obligations. Example indexation terms that are utilised in our contracts can be found on our website for gas³ and electricity⁴.

More generally the industry is exposed to the utilisation of benchmark prices as they feature in the calculations of cash out prices.

Q4: Do you use a single price provider only, or a combination or variety of prices?

Across our two transmission licences we have various subscriptions to receive the products from PRAs and other information service providers such as Bloomberg. The provider used, depends on the specific requirements of that section of the business, dependent on whether the primary interest is in gas, electricity, oil or carbon prices. Some of our system operator incentives will stipulate a specific index to use in a calculation such as that for shrinkage cost targets.

¹<http://www.ofgem.gov.uk/Markets/WhIMkts/EffSystemOps/SystOpIncent/Documents1/20130201%20-%20Direction%20-%20National%20Grid%20Gas%20System%20Operator%20Incentives.pdf>

²http://www.nationalgrid.com/NR/ronlyres/A56B9497-EC8D-4D27-B2A2-8F0ED3D548F5/61362/201315EnergyModellingMethodology_FinalJuly2013.pdf

³http://www.nationalgrid.com/NR/ronlyres/B8C08573-FC8E-4421-A615-AF14B58A65CA/58189/OM_Indexation_Principles_for_Gas_Operating_Margins.pdf

⁴<http://www.nationalgrid.com/NR/ronlyres/3EB0A54E-4759-49D7-9690-BCD18048891C/42439/IndexationPrinciplesDocument2010Final.pdf>

Q6: In the context of GB gas and electricity markets, do you consider the current arrangements whereby price reporting agencies operate under a self-regulatory regime are fit for purpose?

We agree with the points raised in the consultation that there are both positive and negative aspects of imposing stricter regulatory scrutiny on the way that price benchmarking methodologies are constructed and utilised. Whilst enhanced governance may provide further confidence in the benchmarks, there is the risk that this may inhibit market participant's willingness to contribute.

The role of competition and forthcoming REMIT regulation should not be underestimated in enhancing the perceived robustness of the PRA benchmarks. With multiple providers of pricing information, competitive forces should help dictate the provision of robust pricing benchmarks. Furthermore with the comprehensive powers that REMIT regulation will bestow upon Ofgem in their role as NRA for GB, this should act as a further catalyst to enhancing the robustness of the pricing benchmarks. In combination these factors may mitigate the requirement for greater regulation of price reporting agencies.

Yours sincerely,

[by email]

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