British GasTradingLimited
Millstream
Maidenhead Road
Windsor
Berkshire SL4 5GD
www.centrica.com

Mr. Bob Fletcher
UNC Panel Secretary
Joint Office of Gas Transporters
1st Floor South
31 Homer Road
Solihull
West Midlands
B91 3LT

11 February 2011

Dear Bob,

RE: Modification proposal 0333/A: Update of the default System Marginal Buy Price and System Marginal Sell Price

Thank you for the opportunity to respond to this consultation. British Gas Trading (BGT) does not support 0333, and offers comments in respect of 0333A.

We understand that this review of cash-out defaults has been instigated by Ofgem, not as a result of observed or anticipated deficiencies in the current regime, but rather as a good house-keeping exercise, recognising that the current regime has been in place, without change or review, for a number of years.

A cornerstone of the development of the cash-out regime proposed by 0333 has been the requirement that the default values are cost reflective. During the development phase of 0333, a number of values have been suggested, all of which have been argued to reflect the system operation costs of an individual shipper being out of balance at the end of the gas day. In order to justify these various values, a number of definitions of “cost” have been adopted; demonstrating not only the difficulties in arriving at a truly cost reflective solution, but indeed the difficulties in agreeing a definition of “cost”.

What none of the solutions discussed during development – including that put forward in 0333 and 0333A - adequately captures, however, is that the cost to the system operator is a function of the aggregate of all shippers’ balance positions at the end of the gas day, rather than considering each shipper individually.

For example, it could be that the volume of gas by which shippers are “long” on any given day exactly matches the volume by which other shippers are “short. This would result in a perfectly balanced system, and zero cost to the system operator, yet under 0333 there could be significant charges levied on both short and long shippers in this scenario. We therefore cannot agree that the proposed solution is any more cost reflective than the cash-out regime which it seeks to replace.

Whilst a number of options have been debated at length in order to solve this issue, none were developed to a point where we would consider them appropriate for adoption.

Relatively little information has been forthcoming from shippers about how balancing behaviour is shaped by the application of the default values. Certainly evidence provided during the development of 0333 suggested a somewhat inverse relationship between default values and prevailing system average prices; in general shipper balancing has improved as the percentage value of the defaults compared to SAP has reduced. It is, therefore, extremely difficult to assess what (if any) impact this proposal will have on shippers' system balancing, particularly given the very small (and negative) change that is proposed in the first year.

The proposed change does, however, remove the stability and certainty which currently exists, and these attributes tend to be highly valued for the purposes of business planning and customer charge setting. Although data has been provided which suggests that had the proposed formula been in place over the last few years, charges would have been very similar to the current administered levels, this, of course, does not provide any guarantees about future levels or stability, and this could be seen as a retrograde step.

In respect of securing competition between shippers, we would argue that it is the value of the defaults which drive shipper behaviour, and not the knowledge that the values are "cost reflective". Modification Proposals 0333and 0333A argue that: "*By more accurately reflecting the cost of Linepack flexibility within the default cashout price, National Grid believes that this will better facilitate competition as Shipper Users will be better informed as to the price of competing flexibility products and be able to compare the transparent costs of Linepack flexibility against alternative gas sources e.g. storage etc.* We would advise, however, that these proposals have in fact done nothing to better inform us as to the price of competing flexibility products, and we are therefore in no better a position to make informed decisions about how we balance our position on a daily basis.

In summary, therefore, we do not necessarily disagree with the initial default value that is proposed from 1 April 2011, or indeed the formula which is intended to drive default values in subsequent gas years. We do, however, struggle to see how such a change better facilitates any of the relevant objectives, except for facilitating National Grid's compliance with Special Licence Condition C27, Paragraph 3, which requires it to use reasonable endeavours to update the default prices.

Where we do strongly disagree with proposal 0333, however, is in its assertion that Shipper Users should foot the (some might say extortionate) bill for the development and implementation of the accompanying system change. Such a proposal is completely counter-intuitive, given that this proposal stems solely from a licence condition placed upon National Grid. Given the unknown and possibly nugatory impacts upon shipper (either positive or negative), it is evident that National Grid's compliance with its transporter licence is the relevant objective most obviously and materially satisfied through this proposal. The proposed charging split also runs counter to transporters' own guidance on User Pays, as set out in the User Pays Guidance Document.

We welcome the alternative proposal, which has been raised by EDF Energy, and believe that 0333A much better reflects the wording and intention of the User Pays guidelines. To this end, while we still do not believe that it better facilities the relevant objectives overall, were Ofgem to direct implementation of one of these two proposals, we would state a preference for 0333A.

Please contact me if you would like to discuss this response.

Yours sincerely,

Chris Wright
Commercial Manager