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Julian Majdanski  
UNC Modification Panel Secretary  
Joint Office of Gas Transporters  
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Dear Julian

**Urgent Modification Proposal: 0037 Limitation on offering for sale unsold capacity**

Thank you for providing Scottish and Southern Energy plc with the opportunity to comment on the above urgent modification proposal.

SSE is extremely surprised a) that this proposal has been raised at all and b) that it has been afforded urgent status, with less than a week for respondents to comment on the issues. The timescale is particularly worrying given the significant issues that this proposal raises, such as security of supply, the commercial impact on shippers and the ability of shippers to land gas to meet the needs of their customers. In our opinion this proposal represents an abuse of the governance process and we do not understand why Transco NTS has left it so late to bring this proposal forward.

- Transco NTS's justification for urgent status is on the basis that the proposed revisions need to be in place and effective prior to the invitation being issued for the next long-term auctions which are currently scheduled to take place in September 2005. In addition Transco states that without these provisions in place there could be an adverse commercial impact on Transco NTS and Users as a result of *potentially* high buy back costs at Aggregate System Entry Points (ASEPs) We note that Transco NTS has made no attempt to quantify the extent of the commercial impact, nor has it indicated the volumes of capacity that could be involved.
- SSE challenges the justification made for urgency. In fact, in the very limited time we have had to consider the issues set out in this proposal we believe that the issues of concern to Transco NTS are not matters to be resolved via a UNC modification proposal. Rather, we are firmly of the view that this proposal is at odds with our understanding of Transco NTS's licence obligations to release unsold entry capacity and that any issues that Transco NTS has with these obligations should be addressed via licence modification/price control negotiations with Ofgem. It is not appropriate to use the UNC as a means of "getting round" the licence obligations.

- In support of this view we note the statement made by Ofgem in paragraph 3.16 of its Explanatory notes to accompany the section 23 notice of proposed modifications to Transco's Gas Transporter Licence: "The designation of capacity as obligated incremental capacity does not oblige Transco physically to provide the capacity but does oblige it to offer that capacity for sale for each day in every year for which it has declared that it will be available. As with NTS SO baseline capacity, Transco is obliged to continue offering any unsold volumes of this obligated incremental capacity for sale until (and including) the day on which the capacity is to be delivered and must, if the capacity has not been sold earlier, offer it for sale in a clearing allocation on the day of delivery."
- Given this statement we do not understand why Transco is seeking to address its concerns with licence obligations via a UNC modification proposal. Indeed, in doing so, Transco NTS would appear to be avoiding due process. Furthermore that it would appear reasonable to assume that unless it is more efficient or economic to buy back Transco would physically provide the capacity.
- Our understanding of the TO and SO incentive regime framework for the NTS entry capacity regime is as follows:
  - Transco must release for sale a volume of baseline capacity, for which it receives TO allowed revenue. However, under this urgent modification proposal Transco would not even be required to release unsold baseline capacity. In our view therefore, if this proposal were to be implemented Transco would be in breach of its licence obligations; and
  - In response to the signals received via the auctions, coupled with other planning information, Transco will determine whether or not to release additional, incremental "obligated" capacity for which it receives SO incentive revenue. The decision as to whether or not to release obligated will be influenced by Transco NTS's assessment of the reward of releasing the incremental capacity vs the buy back risk. It should be noted that the entry capacity product sold in the auctions is a financially firm product. It is up to Transco NTS to determine whether or not to invest in a physical asset to underpin that financially firm right. We therefore disagree with Transco's reasoning that its obligation to release unsold entry capacity should be curtailed in circumstances where it considers there to be a significant risk that the capacity offered for sale cannot be physically delivered.
- We believe such an approach would significantly undermine the existing basis on which capacity is made available, offered and delivered as well as the incentives regime.
- With regard to the ability of Transco NTS to physically deliver the unsold obligated capacity offered as QSEC within the three year timescale again we would note that this changes the whole basis of the incentive framework that was agreed at the time of the last price control review. We therefore query whether it is appropriate for this change to be pursued under the UNC governance arrangements.
- Furthermore, if Transco NTS's reasonable assessment is that the risk of buy back costs increasing is so high it should surely seek to renegotiate the buy back

element of its incentive scheme with Ofgem. We note that Transco has not provided any evidence to support its concerns that the cost of buy back is going to be so high therefore it is impossible for us to quantify the consequential risks that shippers would face.

- Finally if the level of buy back costs to be incurred as a result of releasing unsold entry capacity is inefficient this suggests that either the baseline levels were set too high, or that Transco's decision to release incremental obligated capacity has not been efficient. If the volumes that have been allocated as obligated are inappropriate this suggests a need to revise the IECR and not the UNC.
- Transco NTS has provided no information about the impact that this proposal would have on its ability to recover TO Allowed Revenue in respect of unsold capacity that comes within the baseline. Our interpretation of the UNC definition of Unsold NTS Entry Capacity is that it includes all categories of firm entry capacity, from QSEC to DSEC. This means that if this proposal were implemented Transco would be entitled to withhold for sale the 20% of baseline capacity held back from the long-term auctions for sale in the AMSEC auctions plus any unsold baseline from the QSEC auctions. What impact might this have on the TO revenue recovery position? We therefore disagree with Transco's assertion that this proposal does not impact on price regulation.
- We also query the impact this proposal would have on shippers' abilities to meet customer demand and their bidding strategies. Some shippers may have decided not to purchase capacity in the long-term auctions in the knowledge that a certain volume of baseline would be released via the AMSEC auctions. Shippers intending to fine-tune their positions would have that option withdrawn from them. This is completely at odds with our understanding of the licence obligations placed on Transco which were designed to ensure that all unsold capacity was made available to market, particularly capacity that is accounted for under the TO revenue stream.
- We query the impact that this proposal would have on withdrawal of gas from storage facilities. Because the need for NTS entry capacity to withdraw gas is typically seasonal we conclude that not to make unsold capacity available would inevitably be detrimental to security of supply if shippers cannot get access to unsold capacity in the shorter-term.
- Restricting access to Unsold NTS Entry Capacity is also a barrier to new entrants and therefore detrimental to competition in shipping and supply.
- It is not for the UNC to remove the potential for shippers to obtain unsold capacity solely on the expectation that they will receive buy back payments. If Transco considers that a party is abusing its position, there are licence and Competition Act provisions to guard against this.

### **Comments on the legal drafting**

As stated above, we are concerned that the definition of Unsold NTS Entry Capacity includes all firm entry capacity, irrespective of the category, i.e. whether permanent obligated, annual obligated, unsold baseline or unsold held-back baseline.

In proposed 2.1.5 (c) (iii) (i) it all seems to be down to Transco discretion. How is such discretion to be audited. Who will decide whether Transco's assessment is reasonable? What information will be provided to shippers?

The references to consents, lead times and construction challenges are irrelevant and misleading.

**Conclusion**

In summary, SSE is firmly opposed to the implementation of any aspect of this proposal. In our view, if the proposal was implemented it would represent a substantial change to current arrangements which merits more consideration than the few days we have been afforded. In addition, we believe that Transco would be in breach of its licence obligations and as stated above, we are surprised that it even considered raising this proposal. Notwithstanding that, implementation would also totally undermine the rationale of the SO incentive which was set at the last price control review and upon which shippers have based their commercial strategies.

I hope that our comments have been helpful. Please do not hesitate to contact me in the first instance if you wish to discuss any of the points raised in our response.

Yours sincerely

Katherine Marshall  
Market Development