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Dear John,

### **Modification Proposal 0246, 0246A & 0246B**

Thank you for providing Scottish and Southern Energy plc (SSE) with the opportunity to comment on the above Modification Proposal.

SSE is supportive of proposal 0246B.

SSE does not support proposal 0246 or 0246A.

For clarity, our preference in support for these proposals is as follows: 0246B, 0246A & lastly 0246. SSE supports a solution that incurs efficient costs and one that acts to remove speculative bids. It is our belief that 0246B is the only proposal that meets these objectives. The other mods propose an estimated cost of £4m/year to hedge a potential risk of £20m/year of which only £2m will be recovered from the defaulting party. We do not consider this cost effective. SSE supports an impact assessment to assess the cost benefits and ensure that a licence change would not be a more effective solution.

#### UNC & Licence Inadequacies

The UNC currently allows a User to decline NG NTS requests for credit made 12 months in advance of capacity delivery and instead repeatedly defer the capacity delivery date at no additional cost to itself. At the moment there is a real risk of costs of £100 m associated with Fleetwood to be smeared across the Shipping community. Ultimately this cost is likely to fall on customers to pay. We do not believe that this would be either an economic or an efficient outcome, and allowing this would be directly counter to Ofgem's primary duty to protect the interests of consumers. It would also be damaging for the image of the energy industry at a time of heightened public and political scrutiny over development, operation, pricing and regulation.

SSE believes that the central issue is NGG's entitlement to collect auction revenues from all Shippers irrespective of its own expenditure to satisfy an incremental capacity signal. This is embedded within NGG's Transporter licence, the content of which is a matter for NGG and

Ofgem. We believe that this flawed condition must be rectified as soon as possible, and we would encourage Ofgem to consider re-opening this aspect of the licence ahead of the next scheduled review of the licence. In these circumstances a condition which compensated for actual transporter expenditure would be more appropriate.

### Modification Proposals

The Modification Proposals seek to address two issues;

- 1) Where a shipper has committed to Quarterly System Entry Capacity through long term auctions yet insufficient credit is put in place, the ability to defer capacity delivery at no cost to themselves.
- 2) To remove the lag between auction bid and placing of credit by the bidding User by requiring the securitisation in advance of all new ( and existing)QSEC capacity bookings.

### Retrospective Regulation

SSE does not support 0246 or 0246A because of the retrospective element that requires Users to securitise all existing QSEC capacity holdings. 0246B would apply only to QSEC bookings made after implementation and as such receives our support.

Existing capacity holdings were bought by Users on the basis of the rules and costs in place at the time of purchase. Proposal 0246 & 0246A would change the costs faced by Users in respect of existing capacity holdings, without a corresponding increase in the value of that capacity. Retrospectively introducing additional costs increases regulatory uncertainty and will discourage future investment. This would be counter to the attempts to introduce a regime of User commitment and would be damaging to the industry at a time when significant investment is required.

SSE believes that securitising all existing bookings is inefficient and excessive, and that the credit cost to shippers of doing so will outweigh the benefits. The objective of review group 221 and the risk to be managed was that of specific project failure and the stranding of capacity that would have little use to the industry in general even though industry would incur the smeared costs. The objective was not to protect against company failure where the assets of the distressed company would likely be acquired by another organisation and hence continue to be used and paid for.

### Entry Capacity Risk Assessment

With 0246B all Users wishing to buy new QSEC NTS Entry Capacity will be required to provide security to support their QSEC capacity bids. This security will be known as the USV and will be based on a risk assessment of the Allocated Capacity Values (ACV). Each User's required

USV will be calculated as the User's QSEC NTS Entry Capacity bids at all ASEPs for all years [Y+2 to Y+16 inclusive multiplied by 0.1] + VAT.

### Available Security Tools

Proposal 0246B & A do not seek to restrict the suite of transportation credit tools available to shippers, instead allowing the full suite of UNC transportation credit tools to remain. This differs from 0246, which seeks to restrict available credit tools to Letter of Credit or Deposit Deed. SSE considers that using a full range of credit tools to hedge the risk posed by the debtor is a robust and well established risk management principle. We therefore believe that the existing transportation capacity credit tools set out in the UNC are adequate. Unnecessary restriction will add further cost to end customers.

### Long Term Entry Capacity Default Process

SSE is supportive of the following actions to be classed as “events of User default”:

- the amount determined by the User’s USV exceeds the value of the security in place; or
- any part of the User’s supplied security has less than 30 days validity remaining; or
- the credit rating of any organisation backing any part of a User’s supplied security has gone below the minimum credit rating specified in UNC TPD Section V.

If an “event of User default” occurs, a “default process” will be triggered whereby a notice will be issued to the User by National Grid NTS informing the User of the “event of default” and requiring the User to provide the necessary security to cover at least the User’s USV within the next 10 business days.

Once in default SSE support the 0246B proposal to:

- remove the ability for a User to defer the provision of the security and therefore, for all of this User’s Registered Quarterly NTS Entry Capacity to lapse;
- clarify that the User will continue to be treated as holding the relevant NTS Entry Capacity and will be subsequently invoiced for that capacity. Any failure to pay the above invoices will be treated as a default in the same way as any other transportation debt; and
- allow NG NTS to reject any further entry capacity bids at any ASEP submitted by the User until the above security has been provided.

### **Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter’s Licence) of the Relevant Objectives:**

SSE considers Proposal 0246B would, if implemented, better facilitate the following Relevant Objectives as set out in its Gas Transporters Licence:

In respect of Standard Special Condition A11 1(a), the efficient and economic operation of the pipeline, this Proposal discourages speculative QSEC auction bidding, thus reducing the risk of inefficient system investment and provides an incentive for Users to honour entry capacity auction commitments.

In respect of Standard Condition A11.1(c) the efficient discharge of the licensee’s obligations under this licence, by providing an incentive on Users to book Quarterly NTS Entry Capacity only when required. This is expected to reduce the potential for providing unnecessary physical NTS capacity. By requiring Users to underwrite their anticipated allocation of capacity prior to a QSEC auction and subsequently maintain this underwriting this proposal provides an appropriate level of incentive on Users not to bid in such auctions in a speculative manner.

In respect of Standard Special Condition A11 1(d), the securing of effective competition; proposal 0246B whilst extending the credit arrangements, aims to reduce the Shipper community’s exposure to a User failing to pay for entry Capacity holdings booked after implementation without introducing a prohibitive cost to Users who may wish to take part in the Entry Capacity auctions. SSE believes that this proposal ensures that costs and shipper default risks are allocated appropriately across Users.

Please do not hesitate to give me a call if you wish to discuss this further.

Yours sincerely  
Jeff Chandler  
Gas Strategy Manager, Energy Strategy