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Mr. Julian Majdanski  
UNC Panel Secretary  
Joint Office of Gas Transporters  
Ground Floor Red  
51 Homer Road  
Solihull  
West Midlands  
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Dear Julian,

**Re: Modification Proposals 0116V/0116A/0116BV/0116CV/0116 DV: “Reform of the NTS Offtake Arrangements”**

**Scottish & Southern Energy (SSE) do not support the implementation of Modification Proposal 0116V**

**SSE support the implementation of Modification Proposal 0116A**

**SSE do not support the implementation of Modification Proposal 0116BV**

**SSE do not support the implementation of Modification Proposal 0116CV**

**SSE do not support the implementation of Modification Proposal 0116DV**

Amongst the Proposals which we believe, if implemented, would better facilitate the relevant objectives, we would rank the degree of facilitation in the following order (most favourable first): 0116A and 0116CV.

We do not consider that the proposals 0116BV, 0116DV, 0116V would better facilitate the relevant objectives.

In summary we believe that 0116BV, 0116DV, 0116V will have the following detrimental effects:

- More complex systems and processes will be required to manage NTS Exit Capacity arrangements.
- Lead to inefficient investment in the network
- Will increase the cost of electricity because CCGTs will be discouraged from operating flexibly or will add risk premia onto PGBTs and BOAs on the electricity market.
- Have a disproportionate impact on bi-directional sites, particularly storage.

- Potentially damage security of supply due to adversely impacting on storage investment and escalation of gas emergencies.
- Discourages competition among Shippers.
- Imposes significant complexity costs on the industry
- Potentially conflict with EU Regulations

SSE has described its thoughts regarding the proposals in detail below:

### **Undue Discrimination**

1. SSE believe it is not discriminatory to treat Direct Connects and DNOs differently. This is because DNOs are subject to a monopoly regulated regime and Shippers are exposed to a competitive market. Therefore, they do not have to be treated the same. Indeed they should be treated differently with DNOs applying to the Transporter for capacity and Direct connects compliant with the existing NEXAs as bilaterally agreed with National Grid Transmission and defined in the UNC.

### **Flat Capacity**

1. The proposals in Mod 116V, 116VD, 116BV and 116CV will not facilitate effective investment signals for NTS exit capacity at Storage Sites. Storage sites are currently designated as interruptible which reflects the bi-directional and counter-seasonal nature of storage operation. Introducing a requirement for Storage sites to purchase firm NTS exit capacity may provide misleading signals to NGG for peak exit capacity requirements because Storage sites would not be operating as an exit point (injecting) on a peak day. This could lead to over-estimation of peak capacity requirements and subsequent inefficient investment.
2. Further, SSE have already provided investment signals through the entry capacity auctions and IECR process for new storage sites. The current proposals would not provide any further information than that already provided, and would mean that Storage Users are required to pay twice to provide the same signal of their requirements.
3. The allocation of prevailing rights as described in mod 116V will be completely ineffective for allocation of capacity at Hornsea and other storage sites. The capacity will be allocated to Shipper Users based on a historic registration in 2005/06. Currently, exit capacity at all storage sites is booked on an interruptible basis and therefore is not registered.
4. If storage capacity was allocated based on 2005/06 historic usage the Users allocated the prevailing right may not be the same in the future or may have a different capacity requirement. This could lead to Shippers being allocated rights they no longer require, and they would need to apply with 14 months notice to reduce them. This would also lead to problems for other Storage Users gaining access to Storage services, as the firm service would already have been allocated to those who happened to use it in the last year. This issue is further compounded because there is no obligation for old Users to assign or transfer capacity and a high price could be demanded for the transferred or assigned capacity. Users will

be reluctant to invest or purchase storage products if they can only gain access to exit capacity through UIOLI at the discretion of NGG. This will impact on future investment in storage and will have a detrimental impact on security of supply.

5. Removal of interruptible status and the introduction of proposals for buy back incentives on NGG will reduce the incentive on end-users to install back-up, potentially further limiting the amount of demand side response. As a result of implementation of these proposals less interruptible capacity will be available at Stage 1 of a Network Gas Supply Emergency. This will lead to a rapid escalation to stage 2 & 3 of an emergency. SSE believe that implementing this reform will have unintended consequences leading to a reduced level of security of supply.
6. The overall effects of the above negative impacts are such that future investment in UK storage will be made more costly and uncertain. This may deter future investment at a time when UKCS reserves are in decline. Taken together these proposals will have a negative impact on security of supply.
7. The proposals would hamper liquidity and trade across the IUK, BBL and Moffat Interconnectors, which is contrary to convergence with Europe and therefore working against the ambitions for a liberalised European Market. With this these proposals the UK is encouraging long term contracts to the potential detriment of new entrants and competition.

### **Conclusions on Flat Capacity**

SSE believes that the proposed rules associated with release of flat capacity:

- would create potentially misleading and ineffective overall investment signals
- would potentially hinder effective access to storage services
- require SSE to pay twice to provide the same signal of their requirements, since we have already signalled requirements through entry capacity auctions
- potentially reduce future investment in gas storage in the UK adversely impacting on security of supply

### **Flexibility Capacity**

1. SSE would be required to establish and maintain sophisticated systems to manage flexibility and there is a lack of clarity about important aspects of the regime such as allocation of prevailing rights and the processes for selection of capacity management tools. These have the potential to profoundly affect the commercial impact of the proposals for Storage Users. The necessity for complex systems will generate costs. The acquisition of flexibility will generate costs. Flexibility Overruns and the SO Commodity (flexibility) charge would also add costs.
2. Allocation of flexibility profiles at multiple-user, bi-directional sites is fundamentally inoperable. This is because it is possible for a flexibility capacity requirement to be generated by two separate storage users nominating against their flat capacity holdings in opposing directions. In this circumstance it is impossible to fairly allocate the flexibility capacity requirement to any one shipper, as it results solely from the presence of more than one party operating at

the storage point. Further, flexibility capacity charges generated in this way cannot conceivably be cost-reflective.

3. NGG has stated that there would be no network investment for flexibility capacity. It follows that removal of the flexibility product would not detract from any objective of the original proposal 116 V to provide investment signals.
4. NGG has demonstrated that the quantity of flexibility available each day is dependent on a number of unpredictable factors and it is therefore impossible to forecast the long term quantities of flexibility available. This does not support the sale of a flexibility product to all users on a long term basis.
5. NGG has had to describe nodal, zonal and network limits on the amount of flexibility capacity available, limited to the lowest amount that National Grid can guarantee to provide at a future date. In reality flexibility is dependent on user requirements which are unlikely to co-incide and is widely understood to be unconstrained in practice. This does not support the requirement for the Transporter to enable unfettered access to system capacity as it creates artificial scarcity of the product. Hence, the system capability would be under-estimated under these proposals
6. For those parties able to forecast more reliably their use of flexibility in advance, mainly DN's, this is likely to be for peak requirements across all days. It is likely that this would not be released to other users until there was certainty that it would not be required by the DN's themselves. This would be very close to the gas day, if not within day. This would result in unused flexibility being unavailable to other users i.e. the original modification would place an artificial constraint on the system.

### **Conclusions on Flexibility Capacity**

SSE believes that the application of the flexibility product:-

- is unnecessary
- is unworkable for bi directional multi user sites
- cannot be cost-reflective
- would create significant cost and complexity

*Extent to which implementation of the proposed modification would better facilitate the relevant objectives*

*Gas Transporter Licence Standard Special Condition A11.1*

- (a) *the efficient and economic operation of the pipe-line system to which this licence relates;*

Mod 116V, BV

SSE believes that investment decisions would not be better informed but that signals could be spurious and produce inefficient and uneconomic investment. The lack of historic data would make the provision of accurate data particularly problematic. In addition, with the effective removal of interruptible capacity, it only being available

at the discretion of NGG, the system will be over engineered with firm exit rights being signalled through the prevailing allocations by interruptible storage sites that are counter cyclical. Consequently less efficient investment will be undertaken than under the existing regime.

#### Modification Proposal 0116A

SSE believes implementation of this alternative Proposal would facilitate the achievement of this objective as it “would enable DNO Users to register their NTS Offtake Capacity requirements beyond September 2010, and allow National Grid NTS to continue to consult and forecast other Users’ NTS Exit Capacity requirements consistent with and pursuant to the relevant provisions of UNC Section O, which would allow National Grid NTS to undertake better informed investment decisions beyond 2010 and thereby better facilitate the efficient and economic operation of the NTS pipeline system.

#### Modification Proposal 0116CV

SSE believes that implementation of this alternative Proposal would facilitate the achievement of this objective by:

- “providing greater transparency of NTS Exit (Flexibility) Capacity availability and utilization, which will enable Users to anticipate constraints that may arise encouraging more co-ordinated planning of future new capacity requirements,
- allowing National Grid NTS to make more informed and efficient investment decisions ensuring costs will not be inappropriately incurred and will be better targeted, thereby
- creating an incentive for those Users best able to manage constraints that may arise to do so more efficiently than National Grid NTS.”

*(b) so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

#### Modification Proposal 0116A

SSE believes implementation of this alternative Proposal would facilitate the achievement of this objective as it “would enable National Grid NTS and DNO Users to formally confirm NTS Exit Capacity levels to support their respective investment decisions beyond September 2010 and thereby better facilitate the coordinated, efficient and economic operation of the combined pipe-line system.”

*(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

#### Modification Proposal 0116V, BV, VD, CV

The substantial costs of implementing and operating the proposed mechanisms are inconsistent with efficient discharge of licence obligations.

#### Modification Proposal 0116A

SSE believe that retaining different arrangements that reflect the specific needs of different Users would be appropriate and duly, rather than unduly, discriminatory. For

example, bi-directional sites would not have their specific usage and impact on the system properly recognised in the charges they would face.

SSE believed implementation of alternative Proposal 116A would “restore the enduring nature of the UNC in a manner that does not require significant implementation costs”. SSE believe the various classes of NTS User are not materially comparable, that there are valid reasons for their different treatment and as such different treatment is appropriate. Gas DNOs are subject to price control regulation, whilst shippers who ship gas to direct connects, storage facilities or export gas through interconnectors operate in the competitive market. Shippers are not in a position to be able to fairly ‘compete’ with DNs for access rights, nor are they necessarily able to provide long term commitments in the same way as such monopoly network businesses whose income stream it ultimately secured through the price control process.

*(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*

*(i) between relevant shippers;*

#### Modification Proposal 0116V

SSE believe that there could be some misallocation of costs between Shippers if costs are allocated to exit as opposed to entry, which would be inconsistent with facilitating effective competition between relevant Shippers, and charges would not be cost reflective.

Shippers are not in a position to fairly compete with DNOs for the proposed products since they operate in a competitive market while the DNOs are monopolies with access to their own diurnal storage.

Increasing complexity creates a barrier to entry and may discourage Shippers from actively competing to supply NTS customers, thereby restricting competition. The increased costs to Shippers of operating in this segment of the market would favour larger Shippers

#### Modification Proposal 0116A

SSE believes implementation of this alternative Proposal would “continue to secure effective competition between relevant Shippers without exposing them to any ineffective competition with DNO Users who are regulated natural monopolies and also subject to Safety Cases which may lead them to act as distressed purchasers in some circumstances;”

#### Modification Proposal 0116CV

SSE believes that implementation of this alternative Proposal would facilitate the achievement of this objective by:

- encouraging an incremental approach to such fundamental reform so as to allow Users (particularly small Users) to become familiar with the obligations the new arrangements place on them whilst lessening their exposure overrun costs
- creating circumstances whereby Users can passively manage their NTS Exit Flexibility) Capacity requirements and exposure which may allow them to avoid costly systems investment and increased resources

- preventing barriers to entry and operational and commercial inefficiencies arising in the supply of gas to NTS Exit Points
- removes a Users exposure to charges which are outside their control that would be generated as a result of actions or omissions by another User
- removes the necessity to build and manage additional systems for which the benefit and requirement are not proven.

(ii) *between relevant suppliers; and/or*

(iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

SSE believes that implementation would facilitate achievement of this objective for the reasons of non-discrimination outlined above in respect of Shippers.

It was acknowledged that competition between DNs would remain limited were the Proposal to be implemented, with few areas in which DNs could be competing to acquire NTS capacity.

(e) *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers; and*

No impact on this relevant objective is anticipated.

(f) *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

No impact on this relevant objective is anticipated.

*The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation*

Modification Proposal 0116V, BV, VD, CV

SSE believes Implementation would remove interruptible load, and hence Stages 2 and 3 of a Network Gas Supply Emergency would be reached earlier than under the existing arrangements since there would be no interruptible loads to take off the system before looking towards firm load shedding. The change in stages of an emergency being reached would change the way in which customers are taken off the system, potentially affecting security of supply for some large users. If existing interruptible sites were no longer geared up to turn off in an emergency, then security of supply could be damaged for other loads. The added costs and complexity of operation were this Proposal to be implemented would have an adverse impact on incentives to invest in storage and hence would adversely impact security of supply.

It may also limit utilization of within day linepack variations to within expected system capability, providing National Grid NTS ensure that all the available NTS Exit (Flexibility) Capacity is readily released. However, bearing in mind that the Uniform Network Code currently contains provisions to do this, and that these provisions have never yet resulted in any over utilization of within day linepack, it is arguable whether it does this better.

*The implications for Transporters and each Transporter of implementing the Modification Proposal, including*

*a) implications for operation of the System:*

Modification Proposal 0116V

SSE believe there could be a reduced willingness to participate in energy balancing mechanisms, adversely affecting system operation, because of the increased cost and complexity of operating in the market. Removing interruption would remove an effective existing tool for managing transportation constraints.

Modification Proposal 0116CV

SSE believes that implementation of this alternative Proposal “would provide a wider range of system management tools for National Grid NTS to manage any transportation constraints. Transporters should also be able to operate their systems more efficiently as a consequence of greater information provision to Users of the use of NTS Exit (Flexibility).”

*b) development and capital cost and operating cost implications:*

Modification Proposal 0116V, BV,VD,

SSE believes that implementation would “have associated cost implications of systems development and ongoing operational costs.”

Modification Proposal 0116CV

SSE believes that this alternative Proposal, if implemented, “would have much lower associated cost implications of systems development and ongoing operational costs. An attempt to capture these was made as part of Ofgem’s Impact Assessments on the potential new arrangements. However, Ofgem will need to update such Impact Assessment in light of this Modification Proposal.”

Modification Proposal 0116A

SSE believe this modification will have the lowest cost implications of any of the variants.

*c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:*

*d) analysis of the consequences (if any) this proposal would have on price regulation:*

Modification Proposal 0116V, BV,VD, CV



The Proposer stated that changes to the National Grid NTS Gas Transmission Transportation Charging Methodology Statement and DNO's Gas Distribution Transportation Charging Methodology Statements would be required as part of the changes to the NTS Exit regime.

*The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal.*

#### Modification Proposal 0116VD

SSE believe that National Grid NTS would “consider any contractual risk of this Proposal as part of its Transmission Price Control Review in which its obligations and incentives in respect of NTS Exit Capacity will be agreed.

The level of contractual risk for each DN Transporter will be dependant on the outcome of its DN Incentive arrangements which are to be brought forward by Ofgem based on a view of the likely enduring arrangements.”

*The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users.*

#### Modification Proposal 0116V

In the event of implementation, SSE believe that operational cost would increase, even if the current IS infrastructure and Gemini systems are used to facilitate the registration of NTS Exit Capacity.

#### Modification Proposal 0116A

SSE believes that implementation would require no changes to existing systems and processes.

#### Modification Proposal 0116BV, CV

The Proposer suggested that implementation of this alternative Proposal, in comparison to Proposal 0116V, would be expected to “lessen the extent of system development. Users are required to undertake to manage their offtake requirements, and their cost exposures under the new enduring arrangements.”

*Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal*

#### Modification Proposal 0116V, BV,VD, CV

SSE believe that interconnection within the continent will be damaged due to complexity and cost, effectively creating a barrier to entry if the above proposals are implemented.

*Analysis of any advantages or disadvantages of implementation of the Modification Proposal*

*We have identified the following advantages:*

Proposal 116A would:

- Avoid inappropriate discrimination between materially different classes of User
- Provide the least cost solution with minimal further impact on the industry
- Enable DNO's to confirm their requirements with National Grid beyond 2010
- Avoid unnecessary costs and complexity

Proposal 116CV would:

- Introduce measures to further inform the requirement for rationing and allocation of flexibility

*We have identified the following disadvantages:*

None of the Proposals gives sufficient information or clarity in relation to:-

- Allocation of prevailing rights for interruptible sites
- Mechanisms by which National Grid would manage Exit Capacity Constraints and the Rules surrounding buy backs.

Therefore we believe that all the Proposals (except 116A) would:-

- Require more complex systems and processes to manage NTS Exit Capacity arrangements.
- May have a knock-on effect on electricity balancing since CCGTs may be discouraged from operating flexibly.
- Have a disproportionate impact on bi-directional sites and hinder effective access to storage services to such an extent that the proposals are unworkable.
- Imposes significant complexity and industry costs.
- Create potentially misleading and ineffective overall investment signals, particularly at Storage Sites.
- Could require Storage Users to pay twice to provide the same signal of their requirements, since many have already signalled requirements through entry capacity auctions.
- Potentially reduce the future availability of gas storage in the UK and affect future investment and security of supply.
- Potentially conflicts with EU Regulations.

*The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation*

Modification Proposal 0116V, BV,VD, CV

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation. Changes to the Transporters' Safety Cases would need to be considered and amended as necessary, subject to HSE agreement.

*Programme for works required as a consequence of implementing the Modification Proposal*

Modification Proposal 0116V, BV,VD, CV

No programme of works has been provided but it is anticipated that the system changes identified in Section 6 above would be major.

*Proposed implementation timetable (including timetable for any necessary information systems changes)*

Modification Proposal 0116A

SSE agrees that “This alternative Modification Proposal would need to be implemented in advance of the effect of the impending sunset clauses, such that the Gas Year ending 30 September 2010 can be considered in any Offtake Capacity Statement issued by National Grid NTS pursuant to Section B paragraph 6.2.1, made not later than 30 September 2007 and pursuant to revisions requested by DNO Users in the Application Window 1 June to 31 July 2007, thereby allowing any requisite investment signal to be made to National Grid NTS and/or DNO Users in a timely fashion.

Modification Proposal 0116CV

The Proposer suggested that the proposed transition timetable set out in respect of Proposal would apply to this alternative Proposal with the exception of NTS Exit (Flexibility) Capacity utilisation information.

Yours sincerely

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Scottish & Southern Energy