

≡ Scottish and Southern Energy plc

Response to OFGEM Consultation on IGT Regulation

Options for IGT Regulation

We agree with Ofgem's conclusions that formal price regulation would require significant licence modifications and involve unquantifiable and probably disproportionate compliance costs. In contrast, relative price regulation would be relatively easy to implement and monitor whilst ensuring gas customers do not face increased transportation charges and we therefore agree that this mechanism should be adopted.

Form and Scope of Relative Price Regulation

We believe that Transco should be the appropriate comparator for IGT charging, given that it is the default service provider. We also believe that the relative price control should be set at the development level rather than the property level so as to allow flexibility in structuring charges and avoid tying IGTs to the detail of Transco's charging structures.

As regards the level of relative comparison, we believe that charges should be set at the Transco equivalent rather than below. We believe that setting charges below Transco's would have an adverse effect on competition in connections.

Ofgem have proposed two alternatives for the path of charges over a control period. Tracking Transco, or RPI-X (RPI indexation is simply setting X to zero). The latter would imply the need for a periodic review to set the X factor, and to reset to Transco levels of charge. If there is to be continual Transco "tracking" there would not appear to be a requirement for a periodic review, and we would support this option, subject to there being no significant rebalancing of Transco charges which affect IGT profitability.

This is linked to Ofgem's next proposal on the period of any controls of relative price control. As stated above, if there is to be continual tracking of Transco charges, there does not appear to be the need for a formal review process. Charges are published and can be verified by shippers, so that any overcharging can be highlighted and enforcement action taken. Indeed, the main benefit of relative price regulation is that it would be self-policing.

Other Issues

Review of Transco IGT charges

As noted above, it is important that the framework of Transco charges is stable so that IGTs are not exposed to uncontrollable risks to their revenues. This could happen if for example Transco's transportation charges reduced though a change in the connection/system boundary such that more costs were recovered through connection charges. If IGTs reduced their charges to the Transco level they would have, in effect, stranded assets that have moved from

“system” to “connection”. In such a case, there would clearly be a case for compensation, irrespective of the timing of any review of Transco’s charges.

Non-Domestic and Rural infill sites, and Annualised connection charges

We believe that it is important to separate transportation and connection for these sites so as to simplify the relative price regulation. We believe it is implicit in this form of regulation that the connection charge is what is left to pay when the IGT takes into account the overall capital installation costs, ongoing operation, maintenance and admin costs, and the revenues from the Transco level of transportation charges. If the costs of connecting the site are such that the consumer would prefer to enter into a special arrangement of partial up-front payment, and partial annualised charges, then this facility should be available subject to acceptable levels of risk. However, it should not appear as a special dispensation to charge transportation charges above the Transco rate.

Use of Standard AOs

We firmly believe that the standard NExA AOs should be used to ensure that all billing is on a transparent and consistent basis.

Unbundling of metering and meter reading charges

We believe that the imposition of unbundling the metering and meter reading charges on IGTs would be a further administrative burden on IGTs and cannot be justified.

Governance of IGT charging arrangements

As far as invoicing arrangements are concerned, these should be sufficiently clear for shippers to be able to easily validate the invoices and we are not aware of any problems with our existing arrangements. The use of standard published AOs as mentioned above would also assist in transparency and validation.

Incentives and low cost sites

We do not believe that relative price regulation will encourage IGTs to focus on low cost sites. Rather the common understanding of the revenue available through transportation charges will tend to increase competitive pressure on IGTs to offer a low connection charge for these sites.

Treatment of Legacy Sites

We believe it is important for all IGT sites to be regulated on a consistent basis. We would therefore support phasing in of these arrangements for legacy sites to a set timetable.

Financial Ring Fencing of IGTs

Ofgem signalled in the May 2002 paper that financial ring fencing would be the subject of a future consultation, and in this consultation they have cited two advantages for customers in applying such ring fencing to IGTs. Firstly, providing some protection from events that may lead to insolvency; and secondly, to allow licensees access to financial markets to fund their activities.

As far as customer protection is concerned, it is not clear how this protection would be provided. Given that most IGTs are small subsidiaries of large organisations, financial ring fencing of the IGT would not give any protection in the event of failure of the parent. In such a case, the IGT could be expected to be sold off as a going concern.

In terms of access to financial markets, IGTs already require funding for their activities and can be expected to adopt appropriate structures so that they can obtain finance. Financial ring fencing would impose a uniformity of structure that is neither required nor appropriate.

We conclude, therefore, that financial ring fencing obligations would form an unacceptable regulatory overhead.