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Dear Sonia,

National Grid Transco – Potential sale of gas distribution network businesses
Interruptions arrangements
Regulatory impact assessment

Thank you for the opportunity to respond to this consultation. This response is submitted on behalf of ScottishPower UK Division, which includes the UK energy businesses of ScottishPower, namely ScottishPower Energy Management Ltd, ScottishPower Generation Ltd and ScottishPower Energy Retail.

We appreciate the efforts of Ofgem in consulting with the industry to determine the impact of a DN sell-off. However, we believe that in regards to the development of the interruptible regime:

- the best options put forward do not require the distribution networks to be sold off
- the current arrangements for interruption could still be accommodated in the event of a DN sell off
- the worst time from an industry participant perspective to make unnecessary and wholesale changes to exit and interruptible arrangements would be concurrent with the other changes associated with such a sale

We believe that Ofgem should undertake a final RIA that considers only the costs and benefits of the DN sale itself rather than including unrelated and unnecessary changes to exit and interruptible arrangements. In fact, we believe that any exit and interruptible regime reform should not only be separate from but should precede or follow such an event by a considerable period, in order to allow time for evaluation of the impacts.

Current Arrangements

Regarding the one-sidedness of the current arrangements, we believe that despite the fact that Transco is obliged to confer interruptible status on supply points on request, each of these sites is providing a service in relation to their position during gas emergency procedures. We accept that there are clear locational differences in the likelihood of interruption, but these also correspond to different benefits on the avoidance of exit charges which are also geographically determined.

We agree that customers should be rewarded in proportion to the degree of interruption applied, or with respect to the likelihood of interruption. However, there should also be recognition of preparedness to be interrupted. This same principle of cost-reflectivity should be carried through to the Transco exit capacity incentives.

The current arrangements are only "transitional" inasmuch as the intention was for universal firm registration. Given the concern over this approach in terms of its workability with different arrangements for interruption, it would be prudent to drop Transco's licence requirement for universal firm registration as soon as possible, to allow for a more permanent arrangement, as well as a wider range of options in reforming the existing arrangements in future.

We welcome the Langage determination, and support a shallow connections policy. However, we are unconvinced that this decision necessitates either a distribution network sale or the changes to the exit regime being proposed by Ofgem.

Key Issues

Freedom to Contract

We agree with Ofgem that there should be no undue discrimination. However, we believe that the level of charges should reflect the level of service provided *or* offered to the system operator.

We also agree that shippers should not be forced to provide interruptible services, but believe that there should be a range of interruptible services available from which participants can chose in order that the requirements of the system operator could be met. At the same time the charges associated with each of these individual levels of service should be transparent and non-discriminatory.

Investment Signals

We believe that a combination of centralised planning and capacity booking provide more efficient investment signals for network owners' pipelines, however, we have doubts about the long term signals coming from the capacity auctions.

Account also needs to be taken in each distribution area of the level of interruption offered, and availability of storage. Should there be a high level of interruption available in a particular network, then interruption should be made on an economically efficient basis – i.e. to those providing lowest cost interruptible services. Alternatively, there should be greater rewards where there is a lack of required interruption or local storage services.

Implementation Costs

In terms of the DN sale itself, we believe that costs should be kept to a minimum, and therefore we would like to see the least change to the existing arrangements. In terms of the reform of the interruptions regime, we would like to see the solution which delivers the greatest benefits in terms of security of supply, impact on customers, and competition. We would not like to see these changes occur as part of the DN sell-off however, as it may be much more difficult to measure their impact on the efficiency of the system as well as the key criteria above.

Direct Contracting

We agree that customers should be given the choice of contracting directly with Transco, although this may cause difficulties in relationships between shippers and their customers, and between shippers and Transco. We believe that in most cases the customer should opt to contract for interruption via their shipper.

Benefits to Competition/Interaction between Markets

Whilst in theory there may be some distortion of competition in retail and wholesale markets, this has yet to be conclusively proved. Nor do we believe that changes to the interruptible regime proposed will necessarily improve this. We believe that new arrangements should promote efficient interactions between gas and electricity markets, particularly given that a significant proportion of those providing the interruptible services are doing so whilst operating in both these markets.

Options

<u>Option 1 – Status Quo</u>

As argued above, we have no serious concerns about the current operation of this regime. We believe it could be improved along the lines referred to above – more choice, more cost-reflective charging, greater number of products – but we would not like to see these delivered bundled up in a DN sale process alongside the associated administrative changes.

<u>Option 2 – Unconstrained Allocation of the Firm Capacity Product</u>

A – pure Matrix

We believe this approach delivers cost-reflectivity and do not see any advantage of option 2A over option 2A* - it goes further but in so doing adds to the complexity of the arrangement for customers & shippers.

B – Tenders for interruption

We believe that this solution is market-based but not necessarily fully cost-reflective. We don’t believe that it is transparent or non-discriminatory.

C – Tenders Plus Matrix
This is even more complex and appears to compound the problem associated with option B.

Option 3 - Constrained Allocation of the firm capacity product

We believe that these arrangements have a striking similarity to those used at entry, and can see massive complexity and problems emerging from this approach. In terms of the individual options, the simpler the better – hence Option 3A would be marginally preferred to the others.

As per the benefits which were expected to be delivered by the reform of the entry capacity regime – we do not trust the assessment of the expected levels of benefits of this approach, and see an incredible amount of time and effort being spent by the industry trying to get these arrangements to work.

All market participants will be affected by these changes – not just those offering interruption. Entry capacity regime changes have led to inflated transportation charges – consistently above the level of inflation – along with volatility and unpredictability. To replicate this on Exit could only be bad news for gas shippers, suppliers and their customers.

NGT have been quoted as saying that any substantial changes to the interruptible regime could not be delivered until 2006. We have already said that we would prefer these changes (if any are needed) to occur outside the changes associated with the DN sale. If Ofgem are to deliberate on the commercial arrangements to support the divested industry structure by August 2004, then we would opt for Option 1 – given that Option 2A* leads to overall industry costs rather than any benefit, and that the complexity and discrimination associated with the other approaches, as well as our experience of similar "reform" does not give us confidence that the other benefits will be realised.

Should you wish to discuss any of the issues raised here, please do not hesitate to call me on the number above.

Yours Sincerely,

Steve Gordon

Commercial & Regulation Manager (Gas)
Scottish Power Energy Management Limited