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Dear Indra

Entry Arrangements for connection to the gas distribution network

I am writing in response to the publication of the above decision document and, in particular, to highlight to Ofgem our concerns with the proposed implementation timetable. We also provide comments on Ofgem's views on the issues that have been raised through the consultation process including some licence drafting suggestions that would, in our view, better reflect Ofgem's position. Finally, we provide some more detailed comment on the proposed draft licence condition.

Before addressing the various points referred to above, we would like to emphasise that we fully support Ofgem's decision that a contractual approach would provide the most appropriate long term GDN entry arrangements. We also understand the rationale behind Ofgem's proposal to introduce a new licence condition to the GDNs' GT licence to mandate the contractual approach and therefore, *in principle*, we do not object to the introduction of Standard Special Condition D12 to achieve this. We do however have significant issues with the proposed timetable.

Timetable

In accordance with previous informal correspondence over recent months, we continue to be extremely concerned by Ofgem's proposed timetable to introduce the new licence condition. As proposed, the licence condition would be implemented on 1st April 2007. On that date, each GDN would have an obligation to enter into negotiations with any proposed new GDN entry point to enable gas to be delivered onto its network from 1st October 2007. While we understand that this would not

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require all physical works to be completed by 1st October to enable the new GDN entry point to be operational, it would mean that all the contractual negotiations would have to be complete by that date. Given a) the volume of work that would be required *prior* to the GDN being in a position to start actual negotiations; and b) the extraordinary volume of work that GDNs are already committed to due to the reform of the expected NTS exit and GDN interruption arrangements, we do not believe that this is a realistic timeline.

Expanding on the first issue, i.e. the volume of work that would be required to enable the GDNs to commence contractual negotiations. In order for negotiations to start, we are of the view that each GDN would have to have developed a standard contract that would be a starting point for subsequent negotiation. This would include not only the GDN entry agreement but, as Ofgem has recognised, it would also be necessary for the GDN to have established other associated documents to support the gas entry agreement including, for example, an ARCA and possibly a review of the Economic Test.

GDN charging arrangements would also have to be established prior to a new GDN entry point commencing commercial negotiations. Clearly, it would not be reasonable to expect a potential new GDN entry point to seek to enter into a commercial arrangement for a connection until the ongoing transportation charging methodology and outturn charges have been determined. To the extent that a change to the current charging methodology is required and a new charge introduced, under normal circumstances this process alone would be expected to take 150 days in addition to the discussions that would have to take place prior to any proposal being raised. In our view, this process alone would mean that a GDN would inevitably be in breach of the six month negotiation window for applications received immediately after the proposed 1st April implementation date.

Furthermore, we believe that it would be necessary to make a number of modifications to the UNC to implement the proposed enduring GDN entry arrangements. Currently, there are a number of areas within the UNC relating to gas entering the transportation system that are NTS-focussed. We believe it will be necessary to carry out a full review of the existing UNC gas entry provisions to establish whether they are sufficiently robust and appropriate for new GDN entry points or whether certain aspects may better reside within the new GDN entry contracts. Likewise, sections of the OAD would need to be reviewed and possibly modified. Any change to the UNC is subject to the modification rules and therefore, the timescales associated with achieving such change is out of the GDNs' control but is likely to take several months.

We mention each of the above to illustrate the volume of work that is required to support the proposed new commercial arrangements. However, the current timetable would mean that all of this preparatory work would need to be developed and completed within the six month negotiation window. This would, therefore, considerably reduce the actual negotiation period for any application received in the months immediately after 1st April.

Although Ofgem has proposed that a GDN could seek the Authority's consent to take longer than the proposed six months to complete contractual negotiations, we do not believe that it is appropriate to introduce a licence condition where a GDN's compliance is dependent upon such a consent being granted.

We therefore firmly believe that Ofgem should revise the proposed April 2007 implementation date of the new GDN licence condition and consider instead an April 2008 date to coincide with the price control licence modifications. Alternatively, if Ofgem is intent on introducing the licence condition in April 2007 to ensure the new commercial arrangements are progressed in a timely fashion, the date in paragraphs 1 and 2 of the current draft would need to be amended to "1 April 2008". Similarly, the date in paragraph 3.a. would need to be amended to "1 October 2008". Certainly, given the above concerns our current thinking would suggest that it would be very difficult for us to accept the licence condition based on the proposed timetable.

Discussion of issues

(i) Maximum available capacity.

We have previously questioned the relevance of the GDN being required to offer terms for the maximum available capacity rather than specifically what the applicant has requested. Ofgem has explained that this requirement is to ensure that a new GDN entry point is informed of the available capacity to which it can have access without triggering system reinforcement work and potential additional cost. In our view, this relates to information being provided by the GDN to a potential applicant, and, therefore, it would be more appropriate to make this an information provision requirement rather than a requirement to *offer terms*.

Notwithstanding the above, we continue to question the relevance of using maximum available capacity as defined. We do not believe that this is particularly helpful for applicants since the one in twenty capacity availability does not refer to all demand scenarios and therefore could be misinterpreted as to what would actually be available on different days. Ofgem has now acknowledged this and has stated that an offer that relates to the maximum available capacity cannot place any obligation on the GDN to provide the stated maximum capacity on any day if it is unable to do so due to constraints on its network. We clearly welcome this but believe that, at the very least, this should be reflected in the proposed licence drafting. This could either be achieved by adding to the definition of "maximum available capacity" to explain the limitation of the definition; or paragraph 2.b could be extended to explain this issue.

A more relevant approach may be to refer to something other than capacity since capacity may be available but system conditions are such that the flow of gas associated with such capacity cannot be "moved" once it has entered the system. This makes the flow rate a more relevant measure of system capability than available capacity. Irrespective of how this is achieved in the licence drafting, the GDN entry agreement would have to specify the network's ability to accept gas under varying demand scenarios in order to provide meaningful information to the applicant. The entry agreement would also clarify under what circumstances any compensation payment would apply if capacity were not available.

(ii) System reinforcement and connection charges.

Ofgem has clarified that GDNs would be able to recover from the applicant reasonable reinforcement and connections costs and the drafting of paragraph 2.c. reflects this. We welcome Ofgem's clarification that if the entry point is of a sufficient load size to warrant system reinforcement work, the GDN would also have the option to establish an ARCA in order to guarantee a certain amount of capacity charges.

(iii) Charging methodology and revenue recovery.

Ofgem has stated that it is for the GDNs to consider what, if any, transportation charges would apply to GDN entry points and consult accordingly and that they would expect the GDNs to work together to develop a broadly consistent methodology. We interpret this to mean that Ofgem does not believe that such co-operation raises any competition issues.

Ofgem has explained that any transportation revenue would be included in the GDN's price control, while connection revenue and capital contribution for system reinforcement would be treated as excluded revenue. Any reinforcement cost not paid for by the new GDN entry point would be included in the RAV at the next price control. This arrangement seems appropriate. However, we should add that our 2008 – 2013 BPQ submission to Ofgem has not included any costs associated with new GDN entry points. Therefore, any significant reinforcement costs incurred by the GDN and not recovered from the applicant during that period would count as an "overspend" and would be penalised under Ofgem's proposed capex incentive mechanism. This would be unacceptable to us unless provision is made to accommodate significant customer driven cost changes during the price control period.

(iv) Bi-directional sites.

In paragraph 3.3 of the consultation document, Ofgem states that the obligations to offer terms to new potential entry points and for that entry point to pay for any reasonable costs incurred in reinforcing the network for entry purposes do not extend to bi-directional sites. Rather, the reinforcement and connection costs associated with a bi-directional site would be consistent with the relevant provisions for offtake. We do not believe that the proposed licence drafting makes this sufficiently clear and would suggest, therefore, that the definition of "gas entry point" should be amended to better reflect this.

(v) Existing GDN entry points.

Ofgem has stated that it expects the existing GDN entry points to migrate to the new commercial arrangements in time. As a point of principle, we do not believe

that it is desirable, and it is not normal practice in the UNC, to have different commercial arrangements in operation for the same product at the same time. In our view, an April 2008 implementation date would be more likely to facilitate the migration of the existing GDN entry points to the new arrangements so that dual arrangements are avoided.

Other licence drafting points.

In addition to the main drafting points included in the above two sections of this response, we have a number of other more detailed drafting comments.

(i) **Paragraph 2.** defines the person who is applying for a new GDN entry point as the “applicant”. We therefore believe that this term should be used throughout the condition accordingly rather than referring to, for example, “the person making the application” or “the applicant person” etc.

To aid clarity, we believe that the drafting of the first half of paragraph 2 could be modified so that it reads:

“The licensee shall (subject to paragraph [5] offer to enter into a gas entry agreement (unless the Authority otherwise consents) on receiving an application to connect a gas entry point on or after 1 April 2008 made by any person (the “applicant”) providing the application contains all such information as the licensee.....”.

(ii) **Paragraph 3.a.** The first sentence should refer to the “licensee” and not the “licence”.

Delete “person making the application under paragraph 2” and insert “applicant”.

We do not support the inclusion of “time being of the essence”, and would prefer “as soon as reasonably practicable”.

(iii) **Paragraph 3.b.** Please note discussion on the use of maximum available capacity above. Delete the “applicant person” and insert the “applicant”.

(iv) **Paragraph 3.c.** Delete the “applicant person” and insert the “applicant”.

We believe the second half of this paragraph should be redrafted so that it reads:

“terms that require the applicant to pay the licensee’s reasonable costs incurred through making any necessary reinforcement to the pipe-line system to which this licence relates or carrying out any other activities necessary to enable the gas entry point to be connected to that system in accordance with the gas entry agreement:”

(v) **Paragraph 3.d.** Delete the “applicant person” and insert the “applicant”.

(vi) **Paragraph 5.c.** We believe this should read “in breach of its Network Code; and”. In our view this would include UNC since each GDN’s Network Code refers to the terms of the UNC.

(vii) **Paragraph 6.** We believe the words “gas entry points” should be replaced by “of this licence condition”.

(viii) **Paragraph 7.** We believe this paragraph could be redrafted so that it reads:

“If after a period which appears to the Authority to be reasonable for the purpose, the licensee has failed to enter into a gas entry agreement with the applicant, the Authority may on application of the applicant or the licensee, settle any terms of the gas entry agreement in dispute between the licensee and the applicant in such manner as appears to the Authority to be reasonable.”

(ix) **Paragraph 8.** We believe this paragraph could be redrafted so that it reads:

“If either part to the gas entry agreement proposes to vary the contractual terms of the relevant gas entry agreement entered into pursuant to this condition, in any manner provided for under such agreement, the Authority may, at the request of either the licensee or the other party, settle any dispute.....”

(x) **Paragraph 9.** Replace “principle” with “principal” so that the heading reads, “Publication of principal terms”. Likewise within the text of paragraph 9.

(xi). **Paragraph 10.** Definition should refer to “gas entry point” singular. While the definition does not include NTS to GDN entry points, it should also be clear that it does not include GDN to GDN entry points.

Definition of “gas entry agreement” the date should not read 1 April 2006. Please see our previous discussion on the implementation timetable. For clarity, we believe the definition could be redrafted so that it reads: “means an agreement made on or after [1 April 2008] between the licensee and a person for the connection of a gas entry point to the pipe-line to which this licence relates for the purpose of introducing gas into that pipeline system.”

Definition of “maximum available capacity”. Please see our previous discussion on this point.

If you would like to discuss any of the points we have made, in particular our concerns in relation to the proposed April 2007 implementation date please do not hesitate to give me a call. In the meantime, I hope you will find the comments we have made helpful.

Yours sincerely

Victoria Hunter
Regulation Manager

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