

Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Claire Rozyn
Ofgem
9 Millbank
London
SW1P 3GE

Telephone: 01738 512909
Facsimile: 01738 456415
Email: Claire.Rathey@
scottish-southern.co.uk

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Dear Claire,

Operating Margins (OM) Contestability

Thank you for providing Scottish and Southern Energy (SSE) with the opportunity to comment on the above consultation. Please find our high level view and answers to the specific consultation questions below.

C3 prices should not be suspended at this time

Ofgem has suggested it may be inappropriate to apply restrictions on charges to NG LNG where a competitive market exists. Whilst we agree with this principle, as stated previously, we do not believe there is effective competition in this market. We maintain that competition may take some time to emerge, particularly as details regarding the safety case have still to be resolved. In previous Ofgem consultations regarding the introduction of competition, it was viewed that this may take at least 2 years for competition to emerge. We believe credible evidence of sustained competition (not just one tender round) is required before any consideration should be given to changes which would allow restrictions applying to NG LNG to be suspended.

Based on information presented by NG in recent OM Statements and Procurement Guidelines Reports, we believe NG LNG continues to command over 50% of the OM market (measured in terms of booked space and storage capacity costs). NG LNG's unit costs are generally higher than most other non NG player. They clearly continue to be a significant player and have a significant influence on OM costs to industry participants.

Even if additional service providers emerge from the 2010/11 tender, we understand their role is likely to be limited in initial years. It is unlikely that NG LNG's market share will reduce to any significant extent. Accordingly, we believe it would be inappropriate to suspend any price restriction applying to NG LNG. We believe it would introduce unnecessary risk for industry participants.

Furthermore, restrictions set out in Condition C3 were set relatively recently and only implemented from 1 May 2008. They were set after a period of consultation by Ofgem and allow NG LNG to charge the TSO the higher of a regulated minimum price (set to recover efficient forward looking capital and operating costs and give a guaranteed rate of return on the proportion of historic assets used to provide such services) or a market price for commercial services sold by NG LNG to Shippers. As such we believe the retention of C3 does not expose NG LNG to any risk in the meantime. Indeed, the price that NG LNG has been able to attract according to data published by NG for all four sites is higher than that obtained by most other non NG players.

SSE believes there are other more significant issues that need to be addressed as a priority to allow competition to emerge. They are far more likely to dissuade potential service providers or have a negative impact on the outcome of the tender process. Issues relate to:

- contractual and commercial arrangements,
- liabilities and
- HSE requirements.

Some of these issues are likely to run into the forthcoming tender years. This introduces inappropriate risk for potential service providers. We maintain it is likely to either discourage potential service providers from taking part and / or had a detrimental impact on the service and prices offered.

Consultation Questions

1. Comments requested on the proposal to amend the licence condition to make it clear Ofgem has this flexibility (to suspend the application of C3 prices in respect of the provision of OM services in some cases and not in others).

NG believe that the market is not homogeneous. On that basis, we do not believe that it will be possible to readily reach a position where it can be shown that these subsets of the OM market are competitive. Indeed we feel it is even more unlikely.

Having just sufficient volume offered to meet requirements does not demonstrate a competitive market. A single tender could provide all the volume for an OM type at a very high price. In the past when Ofgem have assessed competition for TPA exemption for storage projects, detailed HHI studies were undertaken to prove competition. The same approach should be taken here. We do not believe that the market should be split; therefore there is no need for Ofgem to have the flexibility to do so.

2. Comments requested in respect of how Ofgem consider whether competition has been effective.

In previous Ofgem consultations regarding the introduction of competition, it was viewed that this may take at least 2 years to develop. We believe credible evidence of sustained competition (not just one tender round) is required before any consideration should be given to changes which would allow restrictions applying to NG LNG to be suspended.

As noted above, NG believe that the market is not homogeneous. On that basis, we do not believe that it will be possible to readily reach a position where it can be shown that these subsets of the OM market are competitive. For example, having significant volume offered to meet a particular requirement does not demonstrate a competitive market. A single tender could provide all the volume for an OM type at a high price. In a homogeneous market, it would be possible to carry out a standard HHI test. In a non-homogeneous market it will obviously be more difficult to pass such a test, but that should not prevent its application.

3. Comments requested on undertaking a licence modification to change the wording of Special Condition C3 for the reasons set out.

We do not support the suspension of C3 prices at this time. Therefore we believe that the proposed Licence Condition amendments are also not required at this time.

I hope that our comments are helpful. If you would like to discuss any of the points raised in more detail, please do not hesitate to get in contact.

Yours sincerely

Claire Rattey
Regulation Analyst