



Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Lewis Hodgart
Senior Manager – Gas Transmission
Ofgem
107 West Regent Street
Glasgow
G2 2BA

Telephone: 01738 512909
Email: Claire.Ratthey@sse.com

Date: 11th February 2011

Dear Lewis

Update consultation on National Transmission System (NTS) flexibility capacity

Thank you for providing SSE and SGN with the opportunity to comment on the above consultation document. We have detailed our answers to the consultation questions in the attached annex, however we would like to take the opportunity to reiterate our high level views.

The energy sector is facing major investment challenges over the next decade or so, with the need to green the energy mix, maintain security of supply, while at the same time minimising the cost to customers. Whilst Ofgem, NGG and many others have conducted scenario and stress test analysis in an attempt to forecast what the future energy market could look like, there is still a significant level of uncertainty, particularly in relation to future gas supply assumptions, demand patterns and system flows. SSE recognises that as a consequence of the challenges facing the energy sector, demand for system flexibility may increase in future years. However, if demand does not increase any investment in flexibility capacity carried out in the interim will effectively gold plate the system and impose unnecessary costs on TCCs, GDNs, shippers and ultimately gas customers.

We do not believe NGG has provided sufficient evidence to warrant any further investment in system flexibility during the period 2012/13 and 2017/18. As such we do not believe it would be in the interest of current or future customers to allow significant investment at this stage. Indeed we believe it would be contrary to the RIIO principles which require well justified business plans. Instead, we support the approach set out by Ofgem in the consultation document which focuses on continued monitoring and development of the reporting framework.

We also note that NGG's current proposal for the disposal of some of its NTS assets in 2013 to its subsidiary NG Carbon (for CO2 transportation), appears to directly contradict NGG's statement that it had identified a significant need for system flexibility investment in the period 2012/13 to 2017/18. It is vital that a consistent approach is taken when addressing such proposals to avoid uneconomic and inefficient investment or disposal. This is of particular concern to SGN given the impact such disposal would have on offtake etc in Scotland.

We continue to support the work being carried out through the Ofgem capacity workgroup. We continue to believe that: NTS flexibility capacity is a direct function of flat capacity; and that as investment is carried out to meet the long terms needs for peak flat capacity, sufficient flexibility capacity should be available to meet the demand for flexibility capacity. As no previous investment has been undertaken for the provision of NTS flexibility capacity, we question why NGG believe it is required going forward and request that further clarity is provided.

As discussed in the Ofgem workgroup, if it is proven that investment is required in order to meet future flexibility requirements, there are a number of options as to how it could be provided. For example it could be provided via: investment in pipeline; investment in additional compressors; or run compressors harder. Clearly some of the costs associated with these options are capital costs and others are operating costs. Given the dynamic and integrated nature of the network, it is difficult to see how costs or benefits could be attributed to any particularly party e.g. entry or exit and distinguish between SO and TO costs. However, if investment in system flexibility is proven to be required, it is vital that Ofgem establish whether the costs associated are SO or TO costs, in order to drive or incentivise the correct behaviours and avoid cross subsidy.

Until NGG is able to provide evidence that further investment is not just a possible requirement, but is truly a necessity, we do not believe such investment should be made.



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

Annex 1: Consultation Questions

Chapter 1

1. Do you agree with our definition of system flexibility?

Yes. However, we continue to believe that confusion still exists in regards to the difference between flexibility capacity products, and commodity products, such as linepack.

Flat capacity is booked in order to meet peak daily demand within the year. Flexible capacity is primarily the inherent capability to meet changes in demand within day. To the extent that peak capacity is not being fully utilised, there should be inherent flexibility within the pipeline. The need for flexible capacity is usually greatest at shoulder periods e.g. spring and autumn and around the breakfast and tea time peaks where you can see significant step changes in demand. When you are at or close to annual peak demand, profiles tend to flatten out and the need for flexibility capacity diminishes. This should not be confused with commodity products such as linepack which is the gas in a pipeline needed to maintain pressure / flow and balance gas supply and demand within day.

We also believe there needs to be greater distinction between SO and TO costs and functions.

2. Do you agree with our view that the ability to vary gas flows on entry and exit is valued by Gas Distribution Networks (GDNs), Transmission Connected Customers (TCCs), Aggregated System Entry Point (ASEP) operators and gas shippers?

Yes.

Chapter 2

1. Do you agree with the system flexibility indicators developed by NGG?

The system flexibility indicators proposed by NGG are a good reflection of some of the key drivers for system flexibility in today's market. However, the list of indicators is not exhaustive and the degree of their individual and combined influence is uncertain.

Due to the major challenges facing the market over the next decade or so, it is vital that these indicators are reviewed at regular intervals to ensure they remain fit for purpose and to better understand the degree of influence.

2. Do you consider that the system flexibility indicators are capable of identifying future system flexibility investment needs?

For the reasons set out in question 1 above, we do not believe it is possible to identify future investment needs based on the indicators. We believe too much uncertainty remains. We are also concerned that by looking only at undiversified demand, the potential requirements may be greatly overstated and current system capability may not be fully utilised and could result in unnecessary and inefficient investment.

In the interests of economic and efficient investment, we believe any future investment should be based upon clear evidence of future need and scarcity, rather than possible future need and should only be undertaken where there is a well justified business case.

3. Do you agree with our high-level analysis of the factors likely to affect future gas flows on the NTS? Are there important trends which we have not considered?

We agree that the factors proposed may impact future gas flows on the NTS. However, due to the major challenges and uncertainties facing the market over the next decade or so, it is vital that these indicators are kept under review. Until NGG is able to provide evidence that further investment is not just a possible requirement, but is truly a necessity, consistent with the RIIO approach, we do not believe such investment should be made.

As set out in the covering letter, we also believe the investment and costs referred to are associated with managing system flows and pressures and as such are SO rather than TO costs.

Chapter 3

1. Do you agree with Ofgem's representation of how shippers and TCCs manage their NTS exit flow variation requirements?

Yes.

- 2. Do you have any views on the effectiveness of the existing UNC Offtake Capacity Statement (OCS) process applying to GDNs NTS exit (flexibility) capacity bookings and do you consider that the UNC adequately supports shippers flexibility capacity needs?**

SSE and SGN believe that the UNC adequately supports Shippers' and GDNs' flexibility capacity needs. We are not aware of any significant concerns regarding current arrangements. Our only concern would be in relation to transparency of the process particularly where NG NTS has indicated it would not be able to meet a GDN's requirements at a specific offtake in full. It would be helpful to have a better understanding of why this may be the case and potential availability at other offtakes before GDNs submit the initial request to allow them to better align their requirements to capability and avoid further adjustment within the tight timescales allowed. That said we understand the interactive and dynamic nature of the system which makes it difficult to predict such things with full certainty. In some cases the optimum solution can only be identified through bilateral discussions.

- 3. Would it be appropriate for NGG to consider investment to provide GDNs with incremental exit flexibility capacity?**

As indicated in the covering letter and above, we believe further work is required to understand why this may be necessary and consider what options may be available, other than simply investment in the NTS pipeline.

In the interests of economic and efficient investment, SSE believes any future investment, whether for GDNs or other parties, should only be undertaken where there is clear evidence that there is a definite need, it should be proportionate and should be targeted at those triggering the investment and benefiting. As stated above, we do not believe NGG has provided sufficient evidence to date to warrant any further investment in system flexibility during the period 2012/13 and 2017/18. As such we welcome plans for continued monitoring and reporting.

We note that under the RIIO framework GDNs will require a clear signal to be given regarding the cost of providing NTS offtake flexibility capacity in order that efficient trade-offs can be made between investment on the NTS and investment on the DN. Whilst we support the principle, we believe flexibility capacity is predominantly a zero cost product as it is a by product of flat capacity. We do not believe it is likely that the network investment incurred, would provide solely flexibility capacity at exit but would create wider system benefits. To the extent that any costs are incurred in order to meet a GDN's requirements for additional flexibility capacity, we need to ensure arrangements are proportionate and avoid undue complexity

We believe it would be extremely difficult to accurately apportion costs between entry or exit as there are likely to be an associated benefit to the other parts of the network and interactions with system operation. From the evidence presented it would appear that if scarcity exists, it is likely to be driven by changes occurring at entry rather than exit and is likely to result in system operation costs, rather than TO capacity costs.

Chapter 4

- 1. Do you agree with our view of the principles and objectives which should apply to the further development of the system flexibility capacity arrangements on the NTS?**

Yes.

- 2. Do you agree that it would be appropriate to introduce an obligation on NGG to report on system flexibility indicators under the RIIO-T1 framework?**

We believe that all parties would benefit from improved transparency in regards to system flexibility usage and availability and drivers.

- 3. Do you agree that it would be appropriate for NGG to justify any system flexibility investment proposals under RIIO-T1 with reference to flexibility capacity system indicators and specific RIIO-T1 output measures?**

In the interests of economic and efficient investment, SSE believes any future investment in system flexibility should be based upon actual demand for investment rather than a possible future need. Due to the length of the RIIO-T1 price control period, we are concerned that investment proposals under

RIIO-T1 could only be based on forecast need rather than actual need, and therefore result in the gold plating of the system at an unnecessary cost to shippers, GDNs and ultimately gas customers.

As highlighted above, we believe that due to the variable nature of the indicators, the interaction between the indicators and the variable nature of the drivers behind the indicators, at this stage of market uncertainty, we question whether NGG can forecast with any degree of accuracy from such scenario analysis.

4. Do you agree that the commercial and use of system charging arrangements should reflect any costs imposed on the system by NTS users needs to vary entry and exit flows?

If further investment in system flexibility is required, the costs associated should be allocated using a simple transparent allocation mechanism.

We support the principle of cost reflective charging and the desire to avoid cross subsidy. However, the gas network is a dynamic network. Under the scenarios set out in the consultation document we are concerned that any additional investment is likely to be driven by changes at entry and the need to manage different system flows. Even if this materialised as constrained availability of flexibility capacity at exit, it would be inappropriate and difficult to identify and target costs solely at this sector.

Additional Comments

We note the comments in the consultation document regarding potential changes in GDN behaviour since DN sales. Other than changes brought about by interruption reform we are not aware of any evidence to support this view or to suggest there is likely to be any significant change going forward. As stated above, NTS offtake flexibility capacity requirements are predominantly driven by customer demand and move in line with demand for flat capacity. The only significant change in recent years is as a result of interruption reform which has reduced the amount of interruptible capacity available to GDNs and increased the demand for firm capacity within their network and hence flat and flexibility capacity at the NTS/LDZ offtake.