SCOTTISHPOWER

Rupert Steele OBE
Director of Regulation

Andy Burgess
Associate Partner, Transmission and Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

18 September 2013

Dear Andy,

GAS TRANSMISSION CHARGING REVIEW: CALL FOR EVIDENCE

Thank you for the opportunity to respond to your call for evidence on the Gas Transmission Charging Review as published on 24 June 2013.

Our main observations are as follows:

The balance of capacity and commodity charges

It is clearly necessary that the transmission owner and system operator are able to recover their allowed revenues. However, the current pattern of falling utilisation inevitably reduces the amounts payable for entry capacity and is likely to continue to do so unless utilisation rises again. Falling capacity payments will lead to higher commodity charges in order to achieve the SO/TO allowed revenues.

Provided that appropriate notice is given to shippers of the changes (and we would like to see some improvement here), this structure is not necessarily a problem. Indeed, it has the benefit of adjusting automatically to the varying market price for entry capacity.

However, to the extent that high entry commodity charges are perceived as causing problems around interconnectors, it appears to us that there may be scope to ameliorate the problem by increasing the proportion of NTS charges that are recovered on exit and reducing the proportion charged on entry. Such an option would require careful consideration, including the impact on different market participants and the compatibility with EU Tariff Guidelines/Network Codes.

Implementation of ACER's Framework Guidelines

As the consultation notes, a minimal implementation of guidelines would limit their application to interconnector points, and the review will consider whether there could be separate regimes for interconnector and domestic network entry points or whether to apply the guidelines across all entry points. One downside of the latter option would be that it appears that the TO commodity charge could not be used to recover the balance

ScottishPower London Office, 4th Floor, 1 Tudor Street, London EC4Y 0AH
Telephone +44 (0)141 614 2000, Fax +44 (0)141 614 2001, Direct +44 (0)141 614 2012
rupert.steele@scottishpower.com www.scottishpower.com

of the allowed revenues. This would necessitate the development of an alternative revenue recovery mechanism or rebalancing the charges to exit payments.

We have provided responses to your consultation questions in the attached. Please do not hesitate to contact me if you would like to discuss any aspect of this response.

Yours sincerely,

Rupert Steele

Rupert Steele
Director of Regulation

Annex 1

GAS TRANSMISSION CHARGING REVIEW: CALL FOR EVIDENCE
SCOTTISHPOWER RESPONSE

Understanding the issues

1. What has given rise to the current balance between charges for access to the transmission network? How might this change in the future?

The current balance between charges for access to the transmission network has developed over a number of years. Demand for gas has fallen recently as a result of the recession, Government insulation programmes and the high coal and wind generation volumes. In addition, the flows on the gas network have changed with new LNG entry points and the decline of UK continental shelf gas production. In combination, these factors have led to reduced network utilisation and a resultant surplus in baseline network capacity.

This surplus has reduced the appetite of shippers to make long term capacity commitments and led to falling entry capacity prices. In order for the transmission owner and system operator to achieve the allowed revenues, the falling capacity prices must be balanced by higher commodity charges.

The extent to which this trend will continue is dependent on the future evolution of gas demand. There could be upward pressures on gas demand from any economic up-turn and as a result of falling levels of coal generation from plant closures and the carbon price floor. These pressures could be intensified if the Gas Generation Strategy is successful in incentivising new CCGT generation connections. The flows on the NTS could continue to evolve as the utilisation of LNG and storage changes.

The present Gas Transmission Transportation Charging Methodology has TO revenue recovery split 50/50 between entry and exit charges. Although the draft EU Guidelines envisage such a split as the default, they allow NRAs to adopt an alternative if justifiable in terms of the Guideline's objectives. In view of the trends identified above, there could be advantages in charging a greater proportion to exit – though this would need careful consideration of the impact on different market participants and the justifiability in terms of the Guideline's objectives.

2. What issues are there with the current charging arrangements?

In general we do not have many issues with the current charging arrangements and the GB Market Model, which is increasingly being used as something of a template in other national EU markets. However that is not to say that they cannot be improved upon, and we would suggest that there a number of areas that would merit further consideration:

- The trend towards cheaper short term capacity products based on SRMC to maximise efficient use of the network in times of capacity surplus does not incentivise the long term booking of capacity, with potentially adverse implications for investment signals and TSO cost recovery. We can see the value that both short term capacity utilisation and long term investment in capacity bring, but recognise that these to some extent compete. There may therefore be a case to revisit that balance in the Review.

- The use of commodity charges to balance over- and under-recovery elsewhere has caused a degree of unpredictability and volatility in charges that is undesirable and difficult to manage from a shipper's perspective. While using commodity charges is the most sensible solution to ensuring that the necessary revenue is achieved to meet allowed revenue figures, we would welcome fine tuning to give a greater degree of predictability to these charges. We would welcome an approach that seeks to minimise the volatility, introduces some measure of indicative projection of future charges and also provides greater notice of such charge changes to allow shippers to make appropriate adjustments.

- Assuming the issues described above can be addressed, an increased use of commodity charges and commoditisation may be beneficial as we look to a world of increasingly intermittent CCGT generation that will be deployed and utilised to support renewables. That could replace currently fixed capacity charges that may no longer be fully cost reflective due to under-utilisation.

3. How do current arrangements give rise to these issues?

See responses to questions 1&2.

4. In the event that there were to be minimal implementation of the Framework Guidelines/network codes as currently drafted, eg no subsequent changes at domestic points, what would be the impact?

Should GB opt for "minimal" implementation of the Framework Guideline on Tariffs and the consequential Network Code, the new charging regime would in effect apply only to the Bacton and Moffat Interconnection Points.

UK practice in implementing EU directives is (save in exceptional circumstances) not to go beyond the minimum requirements of the measure which is being transposed. That said, operating separate regimes for interconnection points and the domestic market may bring its own complications.

At this stage, we can see two possible options to manage these complications. As noted above (see response to Question 1) it may be possible to ameliorate such issues by increasing the weight of transmission charges charged on exit and reducing the proportion allocated to entry, though the market impacts of such a change and its compatibility with the EU Guideline would need careful consideration.

The other option would be to consider a wider harmonisation of arrangements. However, before any such harmonisation could include the market within GB, the case would have to be carefully assessed to ensure that it did not jeopardise benefits of the existing GB regime. For example the EU approach (as per the latest version of the Tariffs Framework Guideline) is heavily weighted against commodity tariffs, which may reduce such flexibility in revenue recovery and also any option to increase such commoditisation as a way of approaching increasingly intermittent CCGT generation on a more equitable basis.

5. Are our goals for the review appropriate?

We agree that Ofgem's goals for the review are appropriate, although it may be difficult to devise a system that provided the "right incentives" for "all parties".

We agree that whereas the primary goal should be to have a regime that is compliant with the EU Network Codes, it should also as far as possible result in arrangements that minimise distortions. Beyond that, any wider implementation would be voluntary, based on the benefits that it would bring.

We do however have some concerns about the timeframes for concluding a review that is as far reaching as is proposed. This could result in greater uncertainty at a time when there is a particular priority to incentivising investment in new CCGT generation, as evidenced by the Government's Gas Generation Strategy. It will also be important that the implementation of any new arrangements dovetails with the introduction of new EU arrangements – currently anticipated in 2017 - or that any earlier GB implementation is fully assessed to avoid potentially unintended consequences.

6. How could charging arrangements better meet the objectives set out in NGG's special standard condition A5 which sets out the objectives for NGG's charging methodology?

Please see our response to question 7 below.

7. Do the objectives set out in NGG's special standard condition A5 remain fit for purpose? If not, how should they be changed?

We believe that the objectives in special standard condition 5 of NGG's licence remain fit for purpose, although they may benefit from a hierarchy to assist in identifying priorities where there may be potential competing objectives.

8. What other suggestions do you have for the objectives of our review?

We believe that this would be a good opportunity to review the GB charging arrangements to ensure that they are designed in such a way as to attract gas to GB (or at least not the reverse) - as may be the case if the arrangements are inconsistent with those adopted elsewhere in the emerging single EU market. Increasing the percentage of costs allocated to exit would help alleviate these distortions. This would also contribute towards security of supply, where such inconsistent charging arrangements may offset pricing signals that would otherwise have attracted sufficient gas supplies in times of shortage.

9. What is your view on the timescale for our review?

Please see our response to question 5.

10. Bearing in mind the issues and objectives you have identified, what options should be explored to address these?

We believe that at this stage the priority should be to determine the scope of the Review, particularly around the issues of whether the implementation of EU Tariff Guideline/Network Code provisions should be restricted to Interconnection Points or extended to the wider domestic market and whether the review should be all-embracing. Decisions on these aspects would significantly influence the direction and scale of the Review.

11. What are the pros and cons of your suggested option?

The scale of the task would be known, such that resource requirements and likely timescales could be better assessed. This would assist in the identification of issues and options and allow analysis to be focused as required.

ScottishPower
September 2013