SCOTTISHPOWER

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Dear Alena

Gas transmission charging review: Part II - our assessment of potential impact

Thank you for the opportunity to respond to your consultation of 30 January 2015 on the gas transmission charging review. We also appreciate the extensive stakeholder engagement that has recently been undertaken.

Our answers to the consultation questions are set out in Annex 1. In general we do not believe that Ofgem has made a sufficiently compelling case to justify the significant changes proposed to the transmission charging regime, particularly at the current time when there is so much uncertainty around the outcome of the Tariffs Network Code. We would suggest that Ofgem delays making a final decision until the Tariffs Network Code is finalised.

Basis of review

When launched, the review was largely intended to be conducted in the context of the development of the Tariffs Network Code in furtherance of ACER's Tariffs Framework Guideline, with one of the primary purposes being to inform the GB position in the resultant Comitology process. However, allowing for the current state of that development, it is unclear how Ofgem's proposals will interact with, and may yet ultimately be impacted by, the final outcome of the Tariff Network Code negotiations. This will be crucial in determining any final view on the proposals and therefore makes it hard to comment fully on them at this stage.

At this stage the Tariff Network Code outcome remains highly uncertain, with many substantive issues yet to be resolved, either in negotiations between ENTSOG, ACER and the Commission, or through Comitology, either formally or informally, such that the final code may yet be significantly different from where it now stands. In this context, and given that the current system does not appear to be causing immediate problems, we think it would be premature to proceed with the current proposals at this stage, given that there is a risk that the reforms might need to be further amended, or indeed replaced, in the relatively near future.

The balance of capacity and commodity charges

We recognise that it is essential that the transmission owner and system operator are able to recover their allowed revenues. The current pattern of continuing UKCS

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production decline and currently falling network utilisation reduces the amounts payable for entry capacity and is likely to continue to do so, though this may depend somewhat on future utilisation of gas for power generation.

As a consequence, falling capacity revenues have led to higher commodity charges in order to achieve the SO/TO allowed revenues, with that position being exacerbated by an increase in allowed revenues post RIIO. However, provided that appropriate notice is given to shippers of the changes in commodity charges (and we would like to see some improvement here), the current structural split is not necessarily a problem of itself. Indeed, it has the benefit of adjusting automatically to the varying market price for entry capacity. We see no compelling reason to move from a variable commodity charge to a variable capacity charge.

However, to the extent that high entry commodity charges may be perceived as causing problems around interconnectors and distorting cross border-trade, 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 its compatibility with whatever Tariff Network Code ultimately emerges.

Short term capacity discounts

Currently, day ahead and within day capacity products are significantly discounted relative to longer term capacity bookings. We still consider that in such circumstances the short run marginal cost of making such existing capacity available is zero, a principle which has long been recognised in the GB arrangements, and therefore such discounts are effectively cost-reflective. Moreover, the ready availability of such capacity is beneficial in providing flexibility and optionality, which may facilitate short term trading and liquidity.

Modelling reliance

Within the Impact Assessment and throughout the consultation process, Ofgem has recognised the limitations of the modelling undertaken and its robustness. Nonetheless, great reliance appears to have been placed on the model's output in justifying the changes without any wider consideration of potential impacts.

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: PART II - OUR ASSESSMENT OF POTENTIAL IMPACT – SCOTTISHPOWER RESPONSE

Chapter 2: Explanation of our proposed changes to the charging regime

Question 1: What are your views on our proposed changes?

Ofgem is proposing two main changes to the charging regime, which will involve:

- introducing "fully-floating" capacity charges for long-term capacity products;
- changing the charging arrangements for short-term capacity products so that:
  - all users will pay the full "floating" capacity charge component, to recover the historical network cost;
  - the reserve price discount on short-term capacity products will be less than 100% of the long-term capacity reserve price.

As explained in our covering letter, how these proposals interact with and may yet ultimately be impacted by the final outcome of the Tariff Network Code will be crucial in determining any final view. At this stage that outcome remains highly uncertain, with many substantive issues yet to be resolved, either in negotiations between ENTSOG, ACER and the Commission or through Comitology, either formally or informally. As such, any decision to proceed further with these proposals at this stage would have to be sufficiently caveated to allow for further review and reconsideration if warranted by the final code, with the result that making any meaningful progress towards implementation would be challenging and may prove nugatory.

As regards the balance between capacity and commodity charges, we do not necessarily consider the current structural split to be a problem in itself - provided that appropriate notice is given to shippers of the changes (an area that could still be improved upon). Indeed, it has the benefit of adjusting automatically to the varying market price for entry capacity. We see no compelling reason to move from a variable commodity charge to a variable capacity charge.

To the extent that high entry commodity charges may be considered to cause problems around interconnectors with the risk of distorting cross border-trade, 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 its compatibility with whatever Tariff Network Code ultimately emerges.

Question 2: Do you agree with our rationale for rejecting the alternatives? If not, please explain why.

We feel a fuller exploration and analysis of the alternatives than is included in the Impact Assessment would have been merited, and it is not clear whether those alternatives considered represented the full range that may have been available.

One of the primary reasons given for initiating the review was the likely advent of the Tariffs Network Code, which is primarily but not exclusively focussed on Interconnection Points. Yet the option of limiting implementation to those Interconnection Points as an initial first step towards compliance is not fully explored, but rather is dismissed simply on the basis that the existing arrangements are flawed.

Chapter 3: Impact assessment of these proposals

Question 1: Do you think we have identified the relevant quantitative impacts?

We agree that Ofgem has identified the relevant quantitative impacts.

Question 2: Do you think we have modelled the impacts appropriately?

We recognise the extent of the modelling work undertaken and its complexity, and appreciate the efforts of Ofgem, the appointed consultants and the industry stakeholders who contributed to that process. However limitations inevitably apply, as recognised in the Impact Assessment. We agree that for those reasons the results must be interpreted with caution and should not be regarded as being definitive in isolation.

Question 3: Do you think we have identified the relevant qualitative impacts?

The Impact Assessment recognises that it is also important to consider the qualitative analysis supporting the assessment to take due account of the limitations inherent in the modelling. We have not carried out detailed analysis to be able to answer this question fully but we are reasonably comfortable that the relevant qualitative impacts have been identified.

Question 4: Do you have any further evidence of the potential impacts of our proposed changes not covered by our analysis?

The most significant imponderable is the potential impact of the final version of the Tariffs Network Code and how well aligned with, or at odds with, Ofgem's proposals it may be, and the extent to which further review and change to Ofgem's proposals may be necessary as a result.

Chapter 4: Assessment against our objectives

Question 1: Do you agree with our assessment of how our changes would align with our principal objective and statutory duties?

We do not believe that the case assembled and evidence advanced by Ofgem are sufficiently compelling to justify the significant changes proposed to the charging regime at the present time of uncertainty. As far as we are aware, there has been no drive from the industry, including National Grid as the TSO, for fundamental reform of the charging arrangements.

Question 2: Can you provide any evidence that supports or would contradict our assessment against one or more of them?

Consumer bills: we agree the proposed policy changes are unlikely to have any significant impact on consumer bills.

Security of supply: we agree that the proposals should not materially affect GB security of supply overall. There may however be concerns over impacts on the cost of short term capacity bookings which could adversely impact on short term flows that could help manage shortfalls.

Promoting competition: we are unclear what, if any, impact these proposals may have on competition, as in some respects the effect of the changes is simply to redistribute costs between groups of network users.

Question 3: Do you think there are other duties or aims that we should assess these changes against? If so, what are your views on how our changes might affect them?

We would again stress the interaction with the finalised Tariffs Network Code and the risk that these proposals may need to be reviewed or any changes implemented may need to be unwound.

ScottishPower
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