

Andrew Fox
National Grid
Transmission Commercial
National Grid House
Gallows Hill
Warwick
CV34 6DA

Telephone: 01738 457909

E:mail: Jeff.Chandler@
scottish-southern.co.uk

Our Reference:

Your Reference:

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Dear Andrew,

Discussion Document on Entry Capacity Substitution

Thank you for providing Scottish and Southern Energy plc (SSE) with the opportunity to comment on the above Discussion Document.

In response to the specific questions:

Section A.

Capacity Available for Substitution

SSE responded in the TPCR and still maintains that 20% of baseline capacity should be retained on a prompt basis to encourage new entrants. This is required to encourage the development of the remaining marginal upstream projects in the UK.

Forecast Flows

SSE strongly believes that unsold capacity up to the baseline level should be available for substitution. Forecast flows should not be used to determine substitution levels, as these are open to error and manipulation under the TBE process.

Single Quarter

SSE believe that where capacity has not been booked, then that capacity should be available for substitution, irrespective of the number of quarters booked in the future. Having the above policy would prevent the need for complex rules suggested in the discussion document that prevent the short term, distant, booking of capacity. Single quarter booking of capacity may be required for seasonal storage withdrawal and booking capacity to facilitate this should not be discriminated against.

SSE does not have a strong view on whether capacity substitution should result in a permanent adjustment to the baseline of an ASEP. However, SSE strongly believes that a long term Transfer and Trade process should not be permitted as this may result in significant unforeseen consequences. The resulting complexity may act as a barrier to entry dissuading new investment and impacting on security of supply. In addition gaming may

result that disadvantages specific ASEPs and permanently remove capacity effectively stranding those assets.

Section B

Lower NPV Test

It is essential that a single common user commitment test is applied to both incremental investment and substitution. Implementing different tests will add further complexity to an area that is already too complicated. This complexity may act as a barrier to entry at a time when the UK is dependent upon increasing imports.

SSE is concerned that the tampering with the incremental entry capacity rules in order to make relatively minor efficiency savings may result in too much complexity that dissuades investment and results in significant commodity price increases.

Proposals should aim to be as simple as possible based on the principles that user commitment tests should be evaluated at the same time, with the same “hurdle rates” and where competing bids occur the highest is successful.

Section C

Exchange Rate Cap

To avoid excessive destruction of capacity a cap should be applied on exchange rates. However, at this time SSE is not in a position due to lack of information regarding NGG modelling as to what the exchange rate cap should be. Following the independent review of assumptions used in the enduring T&T arrangements then SSE may be in a position to clarify its position.

Section D

Availability of Capacity for Substitution

Multiple ASEP donors should be permitted to satisfy incremental investment signals as this should result in the most efficient use of the network. To avoid undue complexity SSE believes that substitution capacity should be made available at the same time as investment capacity i.e. 42 months.

Section E

Alternative Tests

SSE believes that the current incremental entry capacity regime is too complex and that the substitution proposals will add significantly to this complexity. In particular the derivation of the current “deemed investment cost” of half the NPV investment signal is not transparent.

Therefore, SSE would welcome the opportunity to review and consult upon the user commitment test. The mirroring of the 4-year tests currently proposed in modification proposals 0195 and 0195A have significant merit in their simplicity and would align exit and entry arrangements. Implementation of any such test should be delayed until a full consultation process has been undertaken, such an important consideration must not be driven by arbitrary deadlines such as April 2009 QSEC.

Again SSE does not believe that there should be any different treatment between investment and substitution should the above 4-year test be implemented.

There is merit in considering if certain categories of ASEP should be treated differently. Bi-directional sites, in particular storage sites provide recognised support for the operation of the

network in that their flows are generally opposite to system flows i.e. withdrawal on high demand days. SSE would welcome further consultation on the above principle.

New Entry points

SSE does not consider having separate QSEC auctions for new entry points to be discriminatory. It is important that new investment can be signalled as soon as possible rather than waiting for arbitrary dates. The UNC already supports this for entry.

The timing of the introduction of the substitution obligation should align with a regular QSEC auction, even if this means significant quantities of new incremental capacity are signalled.

If you would like to discuss any of the above points please do not hesitate to contact me.

Yours sincerely

Jeff Chandler
Gas Strategy Manager
Energy Strategy