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Dear Jan,

Consultation Document NTS GCM 01:
Alternative Methodologies for Determination of NTS Entry and Exit Capacity Prices

Thank you for providing Scotia Gas Networks (SGN) with the opportunity to comment on the questions raised in the above Consultation Document.

Q1. LRMCs are calculated from either;

a) Option 1: the Engineering model Transcost, consequentially including peak spare capacity but excluding any backhaul benefit, or:
b) Option 2: Transportation model of the NTS, consequentially excluding spare transmission capacity and including a backhaul benefit equal to the avoided cost of reinforcement:
c) An alternative approach outlined in the Gas TCMF Progress Report GTCMF PR 01.

SGN supports the replacement of the existing Transcost model with a Transportation model of the NTS to calculate LRMCs, although we have some generic concerns about the use of LRMC models to determine charges such as the sensitivity to underlying assumptions. However, of the alternatives presented, the Transportation model appears to have some methodological and some practical advantages compared with Transcost.

The treatment of spare capacity and backhaul in the Transportation model seems to be more appropriate to the current circumstances of the NTS with some of the older terminals declining and alternative sources of supply becoming more important. The detailed modelling of the system required by Transcost, which includes spare capacity and excludes backhaul is both more difficult to carry out and less appropriate for the foreseeable future. Backhaul is likely to become more of a feature of the NTS in the future, and therefore it seems appropriate to include it in the model. Good arguments can be made for including or excluding spare capacity but on balance SGN agree with the case put forward by NG NTS that it will be more cost reflective and result in fairer charges to Users (including DNs) if spare capacity is excluded.

SGN therefore supports Option 2.

Q2. NTS Capacity Prices are determined from either;

a) Option 1: a ten year Supply and Demand forecast using the current Gas Year's Base Case data and network model, or;
b) Option 2: a single year Supply and Demand forecast using the relevant Gas Year's Base Case data and network model for the capacity released.

SGN supports Option 2 as it is consistent with Option 2 in Q1. The determination of capacity charges using a one-year model will have advantages in reducing the reliance that Transcost has on ten-year forecasts. By not forecasting so far ahead the Supply/Demand forecast and the network model should be more accurate and therefore the results should be more cost-reflective. The removal of the ten year averaging will allow NG NTS to provide more specific temporal and locational pricing signals which should enable Users to make more informed investment decisions. It will also remove the circularity in Transcost where LRMCs are based

on future network and supply/demand data which are themselves forecasts of entry auction outturns.

One potential disadvantage of the single year forecasting from a DN point of view is that charges for Prevailing Exit (Flat) Capacity will be set for the forthcoming gas year based on the supply/demand forecast and network model for that year. It therefore appears that DNs will have to apply for Prevailing Exit (Flat) Capacity in July of gas year Y for gas years Y+4 onwards without knowing what the charges for that capacity will be in those years. With the proposal to remove the capping on year-to-year changes in the charges this could apparently mean significant changes in the level of the charges at some exit points between DNs committing to the capacity and actually having to pay the charges. This is simply unacceptable.

Furthermore, under the enduring regime DNs will be required to make economic decisions between booking additional NTS Exit Capacity and investing in their own networks. We fail to see how a DNO can possibly be expected to make efficient trade-offs at each exit point if it does not know the charges more than a year out. In order to make rational and defensible decisions they therefore need to know what they will have to pay for additional Exit Capacity at the time of commitment. Failure in this respect will undermine the whole rationale of NTS exit reform.

Q3, Q4, Q5. These questions deal with the determination of Entry Capacity prices and are not of direct relevance to SGN.

Q6. Entry and Exit LRMCs be calculated from either;

a) Option 1: route costs disaggregated into Entry and Exit costs using the Excel Solver such that in aggregate 50% of route costs are targeted at NTS Entry Points and 50% of costs at NTS Exit points (the average positive values of the entry LRMCs equals the average positive values of the exit LRMCs), or;
b) Option 2: the cost from a “reference node” to each relevant offtake point and the cost from each entry point to the “reference node” and that the LRMCs are adjusted to give a 50:50 split between the average positive value of these adjusted Entry and Exit costs, or;
c) The prevailing methodology.

SGN supports Option 2 as it is consistent with the use of the Transportation model to determine the LRMCs. SGN also supports the continued use of a 50:50 split between adjusted Entry and Exit costs.

Q7. Exit LRMCs are converted into prices using the annuitisation factor set out in NG’s NTS Transportation Licence.
SGN has no objections to the proposal

Q8. The raw Exit Prices are adjusted such that the positive values can be used to set prices to recover allowed revenue and that the negative prices are removed as part of the adjustment step.
Assuming “allowed revenue” in the question means total target allowed revenue from Exit charges then SGN supports the proposal. However SGN does not understand why a similar proposal was not made in NTS GCD01 with respect to adjusting the raw Exit prices in order to recover the target allowed revenue under the enduring regime. (See SGN’s response to that paper under “Other Issues”). Furthermore, we do not believe that it is appropriate to remove negative prices as part of the adjustment step.

Q9. No year on-year capping of NTS Exit Capacity prices is included in the methodology. We believe that consideration should be given to capping any significant increase in NTS Exit Capacity prices.

Indeed, under the enduring regime DNs will be required to make economic decisions between booking additional NTS Exit Capacity and investing in their own networks. It will be extremely difficult for the DNs to make rational decisions in a regime where one element of these decisions, the Exit Capacity charges, may be subject to large year-on-year changes. SGN therefore does not support the proposal.

Q10. The combined Transport and Tariff model used by NG NTS to determine NTS capacity prices to be made publicly available.
SGN supports this proposal.

Q11. The Incremental Entry Capacity price determination methodology is included within the Gas Transmission Transportation Charging Methodology.
SGN has no objection to this proposal.

Q12. This proposal is implemented for price determination in relation to all exit capacity from 1 April 2007 to 30 September 2010.
SGN supports this proposal.

Q13. This proposal (NTS GCM 01) is implemented for price determination in relation to all entry auctioned capacity from 1 April 2007
SGN has no objection to this proposal.

We hope you find our comments helpful, but please do not hesitate to contact me if you have any questions or wish to discuss any points further.

Yours sincerely,

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SGN Distribution Pricing