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Dear Mrs Geitona,

Capacity Allocation on European Gas Transmission Networks – Pilot Framework Guideline

Thank you for the opportunity to respond to this consultation.

SSE is the second largest generator in the UK, with over 11.5GW of generation capacity, 2GW of which is renewable. Additionally, we are the UK's second largest energy supplier, with more than 9 million gas and electricity customers, and we have an electricity networks business which is responsible for around 127,000km of overhead lines and underground cables. We also hold a 50% stake in Scotia Gas Networks (a UK gas distribution business) and operate telecoms, contracting and gas storage businesses. We have a generation and supply operation in Ireland and are currently developing our renewable generation portfolio in Portugal, Sweden and the Netherlands.

We agree that the scope of the Framework Guidelines should be limited to cross-border interconnection points and welcome the harmonisation of procedures and additional TSO cooperation across Europe. However, we do not believe that the Framework Guidelines should focus so narrowly on one single method of capacity allocation and urge ERGEG to include a range of options for capacity allocation.

Our responses to the specific questions are contained in the annex below.

If you would like to discuss our response or require further information, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Samantha Ridsdale', written over a horizontal line.

Samantha Ridsdale
Regulation and European Affairs

General

1. What are your main views of the proposed measures? Do you think Network codes based on these guidelines can achieve non-discriminatory and transparent capacity allocation and the fulfilment of the capacity allocation principles set out in the Third Package of Energy legislation?

Whilst we support the harmonisation of capacity allocation procedures across Europe, we do not believe that capacity auctions are the only way in which to achieve non-discriminatory and transparent capacity allocation.

From our extensive experience of capacity auctions in the UK, we believe that there are several issues relating to auctions which prevent them from being as effective as intended –

- Capacity auctions tend to require excessively large and long term financial commitment. Whilst this may appeal to regulators and TSOs in terms of de-risking the network, commitments of up to 15 years are neither desirable nor feasible for the end users of the capacity. Whilst users must make this long term financial commitment, they are tying up capital which may be more usefully invested in shorter term measures to reduce costs to customers and “green” the energy supply.
- These long term financial commitments can be a barrier to entry for smaller players. This results in exactly what auctions are expected to prevent – incumbents or monopoly parties picking up the majority of capacity, thereby restricting competition.
- The long term financial commitment required shifts all risk to the end users of the capacity. This is not an appropriate balance given the existing range of risks and uncertainties affecting capacity users. This is also particularly relevant in today’s
- Users will normally execute cross-border trades only where arbitrage opportunities exist. If they are forced to commit to long term capacity purchases, they will be exposed to much higher risk in the face of uncertain forward prices and the costs of these risks are ultimately borne by consumers.

Certainly the Framework Guidelines do not require all capacity to be auctioned on a long term basis. However, the withholding of an unspecified percentage of capacity for short term auction serves to distort the market, creating “short” conditions where none actually exist.

An auction can only be effective where there are sufficient participants involved. If there are insufficient participants or if the products offered are inappropriate (i.e. require excessively long term financial commitment), the auction cannot discover the correct price or send accurate investment signals. When this occurs on a regular basis, there is the temptation to “improve” the auction process, which in turn creates more uncertainty and complexity. This has happened in the UK market with the inclusion of substitution, altering the auction process and creating unintended bidding behaviour. It can also be argued that increased complexity of process becomes a barrier to entry for new players.

We believe that capacity allocation arrangements should be determined by each Member State to take into account the regional specificities of each market. Member States may choose to use auctions to allocate capacity but we do not believe that this should be mandated. Whatever arrangements the Member States choose should be consulted upon and ultimately must ensure transparency and equitable access to capacity for all players.

Scope of the Arrangements

2. Do you support the scope of the draft framework guidelines proposed?

We agree that the scope of the framework guidelines should be limited to cross-border interconnection points.

Existing contracts

3. What are in your views are the challenges that existing contractual arrangements create with regard to capacity allocation? What would be the possible ways to overcome those challenges?
4. Should relevant clauses in existing contracts be amended if they contradict the new legally binding set of rules (which will be based on the framework guideline) in order to create a level playing field for all shippers?
5. Experts have discussed if existing / legacy contracts should be questioned if certain conditions are met, in order to free up capacity, which would then be reallocated. Do you consider such a proposal appropriate?

The Initial Impact Assessment notes that no shippers are in favour of amending existing contracts and ERGEG puts this position down to the fact that all of the shipper respondents are party to such existing contracts. However, it could be argued that this is, in fact, an accurate reflection of the position of all of the players involved, because if access to capacity tied up by existing contracts was a significant issue, presumably there would have been more support for change.

We propose that there are actually fewer potential players in the market than is believed by ERGEG and this suggests that there may not be sufficient participants for capacity auctions to work correctly. In this case, the proposed reallocation of capacity may result in all of the capacity going straight back to the parties it was reallocated away from in the first instance. This introduces uncertainty, market risk and additional cost for no real benefit.

If the reallocation of existing capacity is deemed to be necessary, it must be ensured that existing capacity holders are not disadvantaged and that new entrants have fair access to the released capacity.

TSO cooperation

6. Is the scope of the identified areas for TSO cooperation appropriate to ensure efficient allocation of cross-border capacity in order to foster cross-border trade and efficient network access?

We agree that the scope of the areas for TSO cooperation is appropriate.

Contracts, codes and communication procedures

7. Should a European network code on capacity allocation define a harmonised content of transportation contracts and conditions of access to capacity?
8. Should a European network code on capacity allocation standardise communication procedures that are applied by transmission system operators to exchange information between themselves and with their users?

We agree that harmonised contracts and conditions should be defined by the network codes and that TSOs should apply standard communication procedures.

Capacity products

9. What are your views of our proposals regarding capacity products?

We agree that capacity products should be standardised following intensive consultation. However, we have reservations about the only method of allocating these products being by auction.

Breakdown and offer of capacity products

10. Should a reasonable percentage of the available capacity be set aside for firm short term capacity products?

As stated previously, we believe that the withholding of capacity from an initial auction can create artificial “short” conditions which distorts bidder behaviour and price discovery. There should certainly be long and short term products available but withholding one or another in auctions can create undesirable outcomes.

Cross-border products

We support the bundling of cross-border products into one entry/exit product.

Capacity allocation

11. Should auctions be the standard mechanism to allocate firm capacity products?

12. What would be the implications of using auctions for capacity allocation in the markets in which you operate? Is there any way in which auctions can be designed to overcome potential issues resulting from their introduction in those markets?

13. Do you support pro rata allocation as an interim step? If yes, should pro rata allocation only be used in given situations or market conditions?

We do not agree with the assertion that auctions are the most efficient means of allocating capacity. Furthermore, it is unclear how the regulators intend to apply regulated tariffs to merchant interconnectors and how auctions would be expected to work in this instance.

Re-Marketing Booked Capacity

14. Should the network code define harmonised firm secondary capacity products and anonymous procedures for offer and allocation of secondary capacity products in line with those on the underlying primary capacity market?

It is important that users have the opportunity to access capacity that may be booked but no longer required and therefore secondary products may be useful. However, if the initial allocation mechanism is designed correctly, there should be little requirement for secondary trading of capacity.

Booking platforms

15. Do you think that all capacity connecting systems of two adjacent transmission system operators should be allocated via a joint, anonymous, web-based platform?

16. Do you agree that joint allocation of primary and secondary capacity products on these platforms would strengthen capacity markets?



There is merit in creating a booking platform which deals with both sides of the border. However, it is important to ensure that the costs of such a project are proportionate as they will ultimately be passed on to the consumer.