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Dear Mrs Shortall,

Re: Guidelines for Good Practice for Gas Balancing (GGPGB)

Through its gas distribution, storage and supply businesses, Scottish and Southern Energy plc (SSE) is an established and active player in the GB gas market. As such, we welcome the opportunity to input into ERGEG's work. In short, we support efforts that deliberately guard against implementing overly-prescriptive guidelines and consider the Guidelines to be a fair reflection of the underlying Regulation ((EC) No 1775/2005). We do not believe that a single EU-wide balancing regime is necessary, although there are clear advantages at a national-level in ensuring that balancing is both as transparent and as efficient as possible between Member States.

In their current form, the Guidelines are closely aligned with the GB's existing gas balancing regime. GB network users are required to balance their gas inputs and offtakes on a daily basis. The system operator, National Grid Gas (NGG), is responsible for managing the overall system position and performing any residual balancing actions needed to ensure that the system remains in balance. Its actions are incentivised to ensure that it acts in the market's best interests. Any subsequent costs incurred by NGG are recouped from the network users in a way that attempts to reflect each individual network user's contribution to the system imbalance. However, the charges imposed are based upon NGG's marginal costs, which we believe effectively include an element of penalty.

We would strongly argue that ERGEG's Guidelines should be used to specifically rule-out the imposition of a marginal cash-out regime. Although marginal cash-out sends a very clear message to shippers to balance, it is far from being cost-reflective and encourages shippers to go long in order to avoid extreme system marginal buy prices, over which they have little or no control. At times when the system is short, shippers are resistant to put forward offers to alleviate a system shortfall for fear of changes to their own supply-demand position, which in turn can cause a shipper to be short and exposed to an exceptionally high system buy price. What is more, although difficult to quantify, we consider that the marginal cash-out regime places upward pressure on gas prices. Given that the cash-out price provides a transparent and easy reference price for the market, we believe that this influences forward prices, certainly those factored into medium and long-term contracts.

Therefore, although the GB cash-out regime (rightly) does not impose an explicit penalty on shippers who fail to stay within specified tolerance levels, it can, in many instances, be seen to be penal. We would like to take this opportunity to urge ERGEG to provide a steer within the current Guidelines against the use of marginal prices. Our preference would be for a much more cost-reflective mechanism involving, for example, system average prices.

Despite our reservations on the use of system marginal prices, we believe that the GB approach, to a large extent, provides a good example of an efficient and effective balancing regime, which fits well with both the new Regulation and the Guidelines currently being proposed. We support the recommendation that, where a balancing period is deployed, it should be daily. From our knowledge of the GB market, any greater a requirement ignores the practicalities of the system, such as the time taken for gas to flow from the point of input to the point of output. We do not, therefore, believe it is necessary to balance on anything other than a daily basis. In addition, the costs involved in changing an existing system would be substantial and would, almost certainly, outweigh any potential benefits. In fact, a study carried out by ILEX in 2001 on the costs of changing the UK's balancing regime from daily to hourly concluded that the cost would be in the region of £1 billion to £3.5 billion (€1.4 billion to €5.0 billion). This should be kept in mind when it comes to enforcing the eventual Guidelines.

To conclude, the purpose of the Guidelines should be to put forward a set of required principles consistent with meeting the Regulation rather than enforcing a specific 'one-size-fits-all' regime. It should also aim to draw upon experiences from across Europe with regards to what does and does not (e.g. marginal cash-out) work in promoting an effective, cost-reflective and non-discriminatory marketplace. Importantly, we do not view an EU-wide common approach to balancing to be central to facilitating competition in the EU gas market. Whilst this may make operating in various EU gas markets more straightforward, the presence of different regimes does not necessarily pose a barrier to entry or trade. Having said that, the rules in interconnected markets need to facilitate trade between the markets, for example, gate closure rules must allow trade to occur in both directions. In terms of harmonising the EU gas market, however, we believe that efforts would be better targeted elsewhere. Restrictions around access are, in our view, the biggest obstacle to the single European gas market.

I hope this proves to be useful feedback on the proposed Guidelines. Should you require any additional information or explanation, please do not hesitate to contact either myself or my colleague, Gillian Hutton (+44 (0)1738 456263).

Yours sincerely,

Rob McDonald
Director of Regulation.