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Dear Julian

Modification Proposal0035: Revisions to Section Q to Facilitate the Revised NEC Safety Case

Thank you for providing SGN with the opportunity to comment on the above modification proposal.

SGN does not support implementation of this proposal.

It is our understanding that Top-Up arrangements were introduced as a means of ensuring there was a minimum level of gas in storage to see the industry through to the end of a difficult winter. The top-up mechanism was removed some time ago in favour of market mechanisms. It would appear that this was done without full consideration or risk assessment. Safety Monitors have been introduced along with a new type of emergency known as a GSMR Safety Monitor Breach. It would appear that such mechanisms were implemented with the same principles in mind. However a number of aspects give cause for concern.

SGN is supportive of mechanisms that help ensure there are sufficient supplies to meet demand, reduce the need for Transporters to call interruption on their network or avert a potential or actual Gas Supply Emergency. However we have concerns that proposals as they stand are not in the best interest of security of supply and do not facilitate the economic or efficient development of or operation of the pipeline

system. We believe they create perverse disincentives, which could unfairly penalise and discriminate against some Users. This could be detrimental to competition.

SGN note that the above proposal has been justified on the basis that it is required to support changes already made to the NEC Safety Case. It is our understanding that the Safety Case is meant to reflect how the system will actually operate at that point in time. Not how it might work at some point in future, should commercial or other aspects of the regime be modified. We do not believe it is appropriate to make changes without first consulting and ensuring supporting arrangements are in place. We believe the suggestion that the UNC should automatically be amended to fall in line with Safety Case is flawed. Changes should first be made to commercial arrangements so that full consultation can take place with all interested parties such that all implications can be identified, thought through and addressed. If necessary Safety Case changes could be developed in parallel such that they could be implemented at the same time as other commercial arrangements. We believe this approach would be more efficient and transparent and would better facilitate the relevant objectives.

Putting aside the argument that the UNC should be modified to accommodate the NEC Safety Case changes and considering the proposal on its own merits, SGN believes there are a number of aspects that cause concern.

Where there is a potential or actual GSMR Safety Monitor Breach, the NEC may direct the relevant Transporter to direct Users and Storage Operators to turn down or curtail flows and protect the remaining gas in store. SGN is concerned that the proposal fundamentally alters the dynamics of the market, the storage product and could create perverse disincentives for those who have acted prudently to ensure they have sufficient suppliers to meet demand and gas in storage. We believe there is a risk that depending on the level at which the Safety Monitor is set, gas could become sterilised in storage at the start of and throughout the winter. Users who have acted prudently and taken steps to mitigate the risk of supply shortfalls and to balance demand could, through no fault of their own, find that they do not have access to gas in storage. The situation is likely to be exacerbated by the likelihood that at that point in time market prices are likely to be rising. If Users are unable to find alternative sources of gas they will be subjected to an imbalance, caused through no fault of their own, and higher than average cashout prices. SGN believes that at worst this will act as a disincentive for Users to put gas in storage and at best there is a real likelihood that Users will withdraw gas from storage early in the winter or as soon as the system starts to show signs of stress. This is at odds with the original principle behind the mechanism, which was to ensure sufficient gas in storage for use throughout the winter.

We believe these proposals fundamentally change the dynamics of the way the storage product is used, the economics, risk profile and the consequential impact on the rest of the system, Transporters and Users. We are concerned that some of these unintended consequences have not been thought through. We believe they could be detrimental to the efficient and economic development of and operation of the pipeline system and ultimately security of supply. Such perverse disincentives would undoubtedly be detrimental to those Users whose behaviour should be rewarded. This is likely to be detrimental to competition and ultimately security of supply.

It has been argued that this proposal will afford better protection to domestic customers and priority loads. However SGN believes that it could be argued that by sterilising gas in storage this is likely to create additional supply / demand problems and system management problems. We believe it could actually increase the likelihood that other categories of customer will be interrupted more frequently or for longer periods of time.

We need to understand the extent to which the protection of gas in storage and domestic and priority customers is to the detriment of other categories of customer and Users and the extent to which proposal will make it more difficult for a Transporter to manage their system.

At this point in time SGN believes the risks and disadvantages outweigh the potential benefits.

We do not support the proposal. We do not believe the proposals would better facilitate the relevant objectives.

We hope these comments are helpful.

Regards

Beverley Grubb
Scotia Gas Networks