E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
www.eon-uk.com

Richard Fairholme
Tel: 02476 181421
richard.fairholme@eon-uk.com

Andrew Fox
NG House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

June 5, 2007

Dear Andrew,

Re: Review of Incremental Entry Capacity Release (IECR) Methodology Statement 2007

E.ON UK welcomes the opportunity to respond to this document. Overall, we are supportive of the 2007 IECR Methodology Statement, but offer some detailed comments and observations below.

In light of the major industry change that has occurred to date (new baselines, new charging methodology, new IECR), we would strongly encourage NG NTS to publish auction information (even if it is in indicative form) as early as possible; i.e. before the QSEC invitation letter, which normally is only released one month before. Also, we would appreciate clarification on when NG NTS will be releasing a new version of the IECR model, since it is a particularly useful tool for Users.

Our Specific Comments on the Document:

1. Para. 37 – NG state the 42 months as not starting until 1 December 2007, but the previous 36 months lead time started from 1 October. As well as getting an extra six months on the lead time, NG appears to be trying to start it two months later. Having said that, it is stated that this would be 1 April 2011, which we would agree with (i.e. 42 months from 1 October 2007), but that is not consistent with the earlier statement.

2. Para. 40 – The word "expected" at the start of the third bullet point is of concern to us. If NG chooses to extend the 42 months, then the extended release date should be firm as we understand it; not "expected".

3. Para. 56 – This paragraph should cross refer to para 59, where it then states that small ASEPs don't have 20 price steps.

4. Para. 102 – This paragraph should make it clear that it refers to new entry points only. It is appreciated that the heading suggests this, but headings are normally for information only.

5. Para. 109:
    a. Should "$Price_{x,EntryPoint}$" in the formula actually be "($Price_{x,EntryPoint}$ – $Price_{0,EntryPoint}$)"? It is the incremental price above 'P0' that is relevant, as that determines the project cost for the incremental capacity.

    b. A further improvement would be to use "($InitialPrice_{x,EntryPoint}$ – $Price_{0,EntryPoint}$)". The methodology understandably forces the incremental price increments to 0.0001p/kWh/d (see para 107), but is it correct that this should feed through to the calculation of project cost? We believe not, and so the unadjusted 'InitialPrice' should, in fact, be used.

6. Appendix 2:
    a. The price steps are going up in equal steps of 0.01p/kWh/d, so from the formula in Para. 109, the estimate project cost should be going up in equal increments. Thus the P2 project cost should be £4m; not £5m, as stated.

    b. We have some concerns about the project costs being used here. From Para. 109 (as corrected above), taking a price step of 0.01p/kWh/d, a capacity increment of 30GWh/d and an annuity factor of 0.10272, gives an incremental project cost for each price step of £10.7m. Thus in the analysis further down the page, the hurdle would be:

        50% * £21.4m = £10.7m

        The table therefore paints a much 'rosier' picture of how easy it is to pass an NPV test. In reality, a User must bid for incremental capacity for many more quarters than is shown here.

    c. We do not understand how NG achieves an NPV of only £2.67m using the discount rate of 8.3% and an aggregate nominal revenue of £3.10m over just five quarters. Our calculations produce an NPV of £3.05m. It may be because the project cost won't be spent in Q1, but much earlier because of the project lead time. If so, NG should make this assumption clear.

d. Whilst we fully appreciate the above it is only an example, it should be consistent with the rest of the methodology and be accurate. Otherwise, it will just cause more confusion than not including it at all.

Please feel free to contact me on 02476 181421, if you wish to discuss any of the points raised above.

Yours sincerely

Richard Fairholme (by email)
Trading Arrangements
E.ON UK