



Andrew Fox
UKT Commercial
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

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

Richard Fairholme
Trading Arrangements
T: 02476 181421
richard.fairholme@eon-uk.com

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Dear Andrew,

RE: Formal Consultation, Entry Capacity Substitution Methodology Statement

E.ON UK does **not support** implementation of this proposed Entry Capacity Substitution Methodology Statement. We do not believe that National Grid NTS presenting only the 'option' / 'retainer' approach as the culmination of over two years of intensive industry work does justice to the efforts invested by all parties in developing a workable process for entry capacity substitution. We are also concerned to see key questions being asked about the substitution methodology at the final consultation stage (such as an appropriate exchange rate level), which leads us to believe that it is under-developed and risks having unintended consequences, if implemented.

It is our understanding that the fundamental principle behind the introduction of substitution is to avoid sterilisation of capacity. In our view, the 'retainer' approach does not achieve this. Rather, it encourages those with the funds available to protect capacity from substitution, regardless of whether or not they want to subsequently buy it. Equally, over the duration of the 'retainer' commercial priorities might change and a Shipper may legitimately choose not to subsequently purchase the capacity covered by a 'retainer' in a future auction. As a result, an opportunity to substitute and hence to prevent unnecessary investment will have been lost, potentially leading to additional risks and/or costs facing consumers.

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

We are alarmed by National Grid's previously floated idea that the 'two stage auction' approach could be implemented in future years and that the 'retainer' approach could be considered an interim measure. In our view, this would add significant regulatory uncertainty to an already complex entry capacity regime. For instance, if the retainer were to be extended to cover multiple years, how would this fit with a two stage auction covering the same periods in future years?

As regards the impact of substitution on wholesale gas markets, we note that if a Shipper is short of capacity at a specific ASEP, taking out a 'retainer' is effectively flagging to the market that this Shipper is a distressed buyer, potentially resulting in price spikes. Given this concern, we welcome Ofgem's commitment to undertake analysis of the likely impact of this substitution methodology on gas and capacity prices as an integral part of its Regulatory Impact Assessment.

Although National Grid NTS has chosen not to consult on it, E.ON UK believes that the 'two stage auction' approach would fit best with the principles underpinning the substitution obligation and the established gas entry capacity auction regime. It is the only approach that affords shippers a genuine opportunity to influence the outcome of substitution by using existing, familiar tools – i.e. QSEC auction bids. Moreover, it does not permit available capacity to be 'protected' from substitution by anything other than a full user-commitment: the only way capacity can be secured under the 'two stage auction' approach is to buy it.

We believe that a satisfactory compromise for the majority of parties involved would have been for National Grid NTS to consult on both the 'retainer' and 'two stage auction' approaches as part of this final consultation. However, this possible way forward seems to have been ignored and hence we are unable to offer our support for this Entry Capacity Substitution Methodology Statement, as drafted.

Yours sincerely,

Richard Fairholme
Trading Arrangements
E.ON UK