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24 November 2006

Dear Paul

Re: NTS GCD 02: Introduction of NTS Exit (Flexibility) Capacity and Commodity Charges under the enduring offtake arrangements

E.ON UK does not support the introduction of NTS Exit (Flexibility) Capacity Charges or NTS Exit (Flexibility) Commodity Charges.

The unbundling of exit charges into flat and flexibility elements will inevitable create huge uncertainty in the levels of exit TO and SO charges from year-to-year. This unpredictability will add to shippers' risks which will ultimately be reflected in increased charges to customers.

The amount of flexibility that National Grid is able to make available to parts of the country are dependent on the patterns of both entry and exit flows. It cannot be ascribed solely to exit. The profile of flows at entry can, theoretically, have a beneficial or detrimental impact on the level of SO cost, in the same way as profiling at exit can. Under the proposed regime, a shipper will face a flexibility charge even though he may have in fact physically varied input flows at a local entry terminal to match the flexibility supposedly 'used' at entry. We believe it is impossible to divorce flexibility at exit from flexibility at entry, thus to charge one without charging the other is not cost reflective[1].

In reality, SO costs are more likely to be affected by how far in advance hourly flow data can be provided to the SO and the accuracy of that data; whether this is DFN information at the beach or OPN data for NTS users at exit. If the SO has adequate time to prepare the system, it is able to efficiently plan to provide the deliverability needs of its users at minimum cost. Failing this, ramp rates and notice period limit the flexibility so as to not to prejudice the safe operation of the system.

[1] E.ON UK believes an entry flexibility charge has as little merit as an exit flexibility charge, neither provides any real utility for the SO in helping to efficiently manage the system.

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TCCs find it difficult to understand that despite providing the most reliable information of all NTS Users, they now have to face paying an additional new charge for a service which is currently included in a 'bundled' exit capacity charge. The existing "1/24 hourly flow rate" rule ensures that these users already book and pay a fair price for flexibility. This approach to charging is elegantly simple and allocates costs more consistently than the application of separate flat and flexibility charges.

In reality, the flexibility product is of little usefulness to the SO in managing the system and conversations (in private) with experienced system operations staff will confirm this. This lack of utility combined with the fact that the crude design of the product prevents accurate targeting of costs at those parties that supposedly cause those costs (e.g. entry users are excluded), means flexibility charges cannot be described as cost reflective.

In addition, the flexibility product appears to be more about managing energy on the system rather than capacity. By constructing an 'artificial' capacity product, National Grid have managed to use the capacity charging regime to deal with flow rate changes (i.e. energy costs associated with a particular pattern of flow). We therefore consider that, like previous concepts favoured by Ofgem such as linepack services, it would be better to set-out these arrangements under the UNC as an energy balancing matter.

Realistically, the only way in which more accurate cost targeting of changes to within-day flows can be achieved is through the adoption of shorter gas balancing periods, but it is widely understood that introduction of such a radical change would be prohibitively expensive. By expecting users to manage flows across two discrete periods of the day the flexibility product is nevertheless a stepping stone towards shorter-gas balancing periods. Unfortunately, the resulting exit flexibility charges fail to target costs appropriately, whereas dividing the day into two balancing periods might do so.

Detailed Comments

If Modification Proposals 116V, 116BV or 116VD were to be implemented the following comments should be considered:

We support a zero reserve price for NTS Exit (Flexibility) capacity for both the annual and daily auctions. As stated above, we do not believe there is likely to be a correlation between specific NTS TO costs and the crudely designed flexibility product, so it will be impossible to derive a charge that could be described as cost reflective. This is also supported by the fact that National Grid have no intention of investing in their system to provide additional flexibility capacity given that flexibility capacity is a by-product of investment in flat capacity.

Given that it is so difficult to link particular costs with the use of flexibility capacity, the rate might as well be the same for all NTS exit zones. We would, of course, prefer not to have to manage yet another charging element as this will necessarily complicate our contract pricing further and increase our cost to serve. We are, therefore, grateful that National Grid are considering aligning any under- or over-recovery amounts from NTS SO flat and flexibility charges maintaining initial price ratios, as this should help us to manage these charge elements more efficiently as effectively one charge element.

We also agree that the exit commodity charges should together recover 50% of the SO allowable revenue. Please also refer to our response to NTS GCD 01, which questions whether a greater proportion of cost should be allocated to entry rather then exit. As stated above, we really struggle to see how to relate NTS TO costs in any meaningful way to the exit flexibility product.

Please note that our statement of preferences above does *not* in any way imply support for the introduction of a flexibility capacity product and we would ask that National Grid make this clear in any summary of industry responses.

Please feel free to me a call on 02476 183384 if you wish to discuss any of the points made above.

Yours sincerely

Peter Bolitho
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E.ON UK