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Dear Jan,

RE: NTS GCD 04: Revisions to NTS Entry Capacity Reserve Price Discounts

E.ON UK does not believe it is necessary to remove or alter the current reserve price discounts applied to firm and interruptible short-term capacity.

We have a longstanding general concern that reliance solely on auction signals is not the most efficient and economic approach to operating the National Transmission System. We believe NG must adopt a holistic approach to incremental investment in the System that can still continue to value long-term auction signals needed for investment, but which must be supported and reinforced by the use of centralised infrastructure planning.

We do not agree that discounted reserve prices are encouraging shippers to avoid procuring entry capacity in the long-term auctions. It is our view shippers are likely to be purchasing capacity on the day or day-ahead not because they are deliberately trying to pick up capacity at zero or near-zero cost, but because of the need to manage daily volume risk. As such, the availability of capacity in the short-term is a very important portfolio tool and increasing the current costs of procurement could lead to larger risk premiums being passed through to consumers.

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For the benefit of better competition in the gas wholesale market it is also important not to reduce the amount of, or access to, short term capacity: Primarily for the benefit of potential new entrants. If all capacity is tied up in long-term contracts, it could be argued that this leads to foreclosure of the wholesale market. Therefore, there ought to be a certain amount of capacity made available in the short-term. We already have concerns that the amount of short-term capacity held back by NG will diminish from 20% to 10% under the current Transmission Price Control (2007 onwards) and if the scarcity is then compounded by less attractive discounts, then this could lead to a significant barrier to market for new entrants.

Specific questions posed in the consultation:

1. The principle that, in the absence of an indication of effective competition, NTS Entry capacity reserve prices should not be discounted for Daily auctions of firm capacity.

As highlighted above, the primary reason that shippers leave a proportion of their capacity procurement until the day or day-ahead is to manage volume risk efficiently and economically. The apparent “lack” of ‘effective competition’ is not a suitable measure to use as it merely concentrates on what the current competition for capacity is and ignores the effect that new entrants could have at a particular entry point. Therefore, removing a discount based on current perspectives on behaviour at a terminal could discriminate unduly against new entrants and may distort locational signals by forcing Users to procure capacity at other, relatively ‘cheaper’ ASEPs.

2. The principle that, in the absence of a material likelihood of interruption, NTS Entry interruptible capacity should not be auctioned with zero reserve price.

Linking the cost of interruption to the material likelihood of interruption raises many complex issues and we would prefer to see more details of how NG believe this could work in practice before offering our comments on the principle.

3. That secondary capacity trading of Users’ surplus holdings at an NTS entry point is inhibited by the availability, at a substantial discount, of primary capacity at the same entry point.

We would not agree with this statement. In the example cited, there seems to be a surplus of primary capacity at the particular entry point, which may indicate that there is simply no demand for capacity; irrespective of the low reserve price. Hence, whatever the price of primary capacity, the demand for secondary trading will ultimately be limited by the demand for capacity.

Moreover, we would question whether there is really any need to encourage

secondary trading at an ASEP when there is a surplus of primary capacity. Our view is that this issue only becomes relevant when there is a constraint – i.e. for transfers of capacity to sold-out ASEPs. This is when it is potentially desirable to encourage secondary trading.

A more pertinent issue to bear in mind is that when the trades and transfers process comes into effect, different reserve prices within a “zone” may encourage Users to buy capacity at a “cheap” ASEP with a view to transferring it to sold-out ASEPs with a higher reserve price within the same zone, which undermines the principle of different reserve prices for different ASEPs.

4. Whether it is a practical necessity to always have auctions with zero reserve price in pursuit of price discovery and clearance of Obligated NTS Entry capacity.

It is critical to the economic and efficient operation of the NTS to make the full capability of the network available to Users. As the amount of capacity required in the short-term will vary considerably within-day depending on demand, the most ‘cost-reflective’ reserve price can only be zero. To impose any other reserve price in daily auctions would place an artificial restriction on true price discovery, potentially restrict access to market by new entrants and would prevent the most efficient and economic release of entry capacity.

5. Specifically for Day-ahead NTS firm entry capacity auctions – should the 33% discount on NTS Entry Capacity Baseline Reserve Prices be removed, applied conditionally at each NTS entry point (indication that there is sufficient competition in play such as 90% of the capacity available in Quarterly and Monthly auctions is sold.), or retained?

Trying to determine any discount that is anything other than zero or 100% is essentially an arbitrary process and there will always be arguments for and against any number that is chosen. For the sake of clarity and stability, we would prefer to see the existing arrangements for day-ahead capacity retained; particularly as we do not feel there is a problem currently. Applying ‘conditional’ reserve prices at particular ASEPs is both a barrier to market for new entrants and could be considered discriminatory.

6. Specifically for Within-Day NTS firm entry capacity auctions – should the 100% discount on NTS Entry Capacity Baseline Reserve Prices be removed, applied conditionally at each NTS entry point (indication that there is sufficient competition in play such as 90% of the capacity available in Quarterly and Monthly auctions is sold), or retained?

As above, it could be considered discriminatory to apply different rules regarding

discounts at different ASEPs and as such would not facilitate better competition between shippers.

7. Specifically for Interruptible NTS entry capacity auctions – should the 100% discount on NTS Entry Capacity Baseline Reserve Prices be applied conditionally at each NTS entry point (i.e. only when there is a material probability of interruption such as when 90% of the firm capacity available is sold), or retained?

See our response to question 2, above.

8. The effect of discounting on other charges (e.g. TO Entry Commodity Charges) that Users may pay.

We are not clear what problem this question is attempting to address.

9. When any proposed changes to discounts should be implemented or further considered?

Given the introduction of the Transportation Model in October 2007, a pre-winter trade and transfer process to be implemented, new entry substitution arrangements and probable reform of entry interruption arrangements, there is a danger of over-burdening the industry with vast and significant change in a short period of time. All of the above may also result in changes in behaviour and/or potentially mitigate some of the problems NG appears to be currently concerned about. Consequently, we would strongly advocate delaying any possible reform until at least October 2008. Indeed, the need for change may differ substantially in a year's time in light of the overhaul of entry arrangements, so we would encourage pragmatism and caution in any approach to reviewing reserve price arrangements.

If you have questions or queries in relation to any of the issues covered by this response, please do not hesitate to contact me on 02476 181421.

Yours sincerely

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