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

Richard Fairholme
Trading Arrangements
T: +44 (0)2476 181421
richard.fairholme@eon-uk.com

Eddie Blackburn
Regulatory Frameworks
National Grid
Gallows Hill
Warwick
CV34 6DA

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Dear Eddie,

RE: NTS GCD 08: NTS Entry Charging Review

This response by E.ON UK is on behalf of all E.ON group companies operating in the UK currently holding a UNC Shipper licence.

We believe it is appropriate for the industry to consider ways in which an increasingly volatile TO Commodity charge level can be reduced (or better managed), although ultimately it should be recognised that fluctuating commodity charge levels are an inevitable outcome when auctions are used to collect fixed allowed revenue. This issue is simply an illustration of the inefficient nature of auctions and it is not inconceivable that in a few years we will be considering ways to better manage over-recovery by National Grid!

It is worth noting that the volatility in TO Commodity charge is not necessarily a problem, provided the level can be accurately predicted, so that measures can be put in place to deal with it. It is predictability not less volatility which is the most important outcome when setting transportation charges.

Overall, E.ON UK strongly believes that these proposals would not provide an improvement to the UK gas entry charging arrangements, since the anticipated side-effects significantly outweigh the limited benefit of reducing the TO Commodity charge. Our responses to the detailed questions are set out below.

E.ON UK plc

Registered in
England and Wales
No 2366970

Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

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Q1. Whether the objectives of the review are appropriate, namely to identify any charging methodology and/or UNC modifications required to;

a. **Continue to recover allowed revenue while achieving the NTS Licence and EU relevant charging objectives.**
b. **Maximise the proportion of NTS TO target entry revenue recovered through entry capacity charges.**
c. **Appropriately incentivise long term booking of NTS Entry Capacity.**
d. **Appropriately differentiate by price between the NTS Entry Capacity products made available.**
e. **Incentivise Security of Supply.**

Achieving an appropriate balance between long and short-term products

An appropriate balance needs to be struck between incentivising long-term bookings and providing short-term flexibility for both incumbents and new entrants. Efforts to maximise long-term entry capacity bookings by incumbents runs the risk of reducing opportunities for new entrants to enter the market if capacity is wrapped up in long-term contracts.

It could also be argued that long-term entry capacity bookings do not necessarily improve security of supply since this may restrict the flexibility to flow gas, if short-term capacity isn't available in the quantity required when needed. Access to short-term products is also critical for those Shippers who have a large or variable supply portfolio and who will be subject to within-day fluctuations in the size of their portfolio. This may be due to customer churn, electricity demand, weather, maintenance, etc. As a result, it is impossible even at the day-ahead stage for Shippers to know *exactly* what their capacity requirements will be. Moreover, pushing Shippers into procuring capacity purely on a long-term basis would force them to over-state their requirement (in order to manage risks), buying more than they need and sending an erroneous signal to National Grid of high demand, leading in turn to a network which is over-built and under-utilised.

Varying degrees of impact on different Shippers

The review process should also be conscious that not all Shippers operate in the same way and many may have based their business model on the current, established charging structure. Indeed, a reduction in the TO Commodity change is not necessarily a benefit for all Shippers. For instance, those who wish to access the network only at times when this would not cause a cost to be incurred by NGG (such as marginal sources of supply) may be prevented from doing so under these proposals, due to the increased cost of doing so.

In addition, it could be argued that a predominantly capacity-based charging structure would unfairly penalise those sites on the short-haul tariff, which have taken efficient decisions to

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locate close to large entry terminals, thereby reducing the potential size of the network and ultimately saving money for consumers. Due to the benefits they provide, these sites justifiably do not pay TO Commodity charges and therefore remain unaffected by the variable charge levels seen recently. Ultimately, if the regime were to become predominantly capacity-based, the short-haul tariff would become increasingly less attractive, potentially resulting in more inefficient bypass of the NTS.

Limiting the release of interruptible capacity is inappropriate

This review needs to take into account the recently published ERGEG Capacity Allocation Guidelines[1] and whether proposals being advanced here are entirely compatible with the new requirements. The following excerpts of the guidelines should be examined further:

> *"Network codes shall foresee that transmission system operators offer firm and interruptible capacity at any interconnection point in both directions; at unidirectional points."*

And

> *"Registered network users are entitled to submit nominations on an interruptible basis at any time. This entitlement shall not restrict the allocation of firm capacity by transmission system operators."*

And

> *"The network code shall set out the procedures followed by transmission system operators to offer all available capacity in a transparent and non-discriminatory manner as firm and interruptible long and short-term capacity products."*

It could be argued that only offering interruptible capacity once firm has sold out would not be compatible with these guidelines since it would not allow Shippers to "*submit nominations on an interruptible basis at any time"* – only once firm capacity is sold out.

Traditionally, capacity has been offered to Users on an interruptible basis on the understanding that a contribution towards fixed costs of running the system is made. Interruptible services perform a vital role, allowing network usage to be increased in days where there is spare capacity. Therefore, if interruptible capacity can be made available with no impact on the network then it should be released; otherwise there may be accusations of NGG withholding potential network capacity. In a report by NERA for the Gas Forum – "Review of the Proposed Gas Exit Arrangements", it is further noted that:

[1] Capacity Allocation on European Gas Transmission Networks, Pilot Framework Guideline, Ref: E09-GNM-10-05, 10 December 2009

> *"Interruptible service allows users to gain access to capacity even if they place a relatively low value on the capacity and would not be willing to pay much more than the operating costs of using it. A tariff policy that removed this possibility would discourage low value users…These users would be prepared to pay for operating costs and make a small contribution towards the fixed costs of investment, but may not be prepared to pay the full costs of capacity. Discouraging such users from using the network would lead to reductions in network utilisation and consumer welfare."*

Fundamentally, 'firm' and 'interruptible' capacity are different services and should both be made available at the same time: release of one should not be contingent on the other. If it were, there is a risk of discouraging so-called "low value" users from potentially accessing the system, since the cost of doing so would be much more, if full reserve prices for daily auctions are imposed.

Risks increased for Portfolio Shippers

Currently, National Grid is only obliged to hold one within-day auction (but more at their discretion). To minimise risks, Shippers typically over-buy firm capacity, as there will be no further opportunities to buy this capacity within-day and will generally pay zero (or near zero) for the entry capacity. But if Shippers would have to pay the full reserve price, they wouldn't want to over-buy due to the cost, but are then exposed to within-day changes in their portfolio and the risk of holding insufficient entry capacity to meet their needs.

On top of this, at least initially there will still be the opportunity to buy interruptible capacity with a zero reserve price. However, the proposed changes are likely to reduce the amount of interruptible capacity available, given that National Grid is obliged to release it based on the average unused capacity over a 30-day period. As noted above, Shippers typically buy a lot more within-day firm capacity than they need, so this feeds through into a large amount of interruptible capacity being released. However, going forward Shippers will only want to cover their expected flow, so interruptible capacity will be much more limited. Combined, both of these changes are likely to increase Shipper risks if more opportunities are not provided to obtain capacity within-day in order to efficiently manage daily portfolio changes.

Our strong opposition to these proposals would only be moderated if there is a much more active within-day market and/or secondary trading of capacity. To achieve this, National Grid would need to play a facilitation role, introducing as a minimum, more within-day auctions for capacity. This measure would significantly help manage risk and costs for portfolio Shippers. For clarity, we believe this measure would need to be in place, *before* any of the charging proposals were to be implemented. For clarity, we would also not be content with rules that gave NG discretion to release capacity more often (as is the case now) – it is <u>certainty</u> that

Shippers need that capacity will be made available through an established process, which must be codified in the UNC.

Increased Buy-Backs?

This review should also consider the impact of encouraging much more firm capacity to be bought and whether this will lead to more capacity buy-backs by National Grid. If all firm capacity is bought on the day, it leaves NG NTS less room to manoeuvre should flows need to be curtailed within-day. Interruptible capacity can, of course, be interrupted and provides significant flexibility for the system operator. Firm capacity cannot be easily (or cheaply) curtailed, with only potentially costly capacity buy-backs as the available tool for National Grid to manage flows at the affected entry point.

Q2. Whether a phased implementation approach, as suggested by the ECRG, is appropriate, with:

a. **Phase 1 comprising removal of entry capacity discounts; and**
b. **Limiting the release of interruptible capacity to when firm capacity has sold out or is close to selling out.**

No, for the reasons outlined above.

c. **Phase 2 covering further changes in light of experience of phase 1 including the potential re-introduction of price multipliers for daily and monthly capacity.**

If these proposals were ever to be implemented, it would be critical to review "Phase 1" and see the actual impact on charges before considering adding multipliers into the mix. Otherwise there is a real risk of rapidly moving from under-recovery to significant over-recovery. It will also be necessary for the industry to re-consider the report for charging consultation PC 49 – "*Prices for unsold monthly capacity and floor prices for daily capacity Auctions*", which considers in detail the arguments for and against multipliers in capacity auctions.

Q3. Should the 50-50 entry-exit TO revenue split within the Charging methodology be retained or should an increased proportion be allocated to exit with a reduced proportion for entry?

The current split should be retained. Altering it would result in unfair cross-subsidies by exit to entry Shippers.

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Q4. Should the TO Entry Commodity charge continue to apply uniformly to all entry gas flow allocations excluding storage and "short-haul"?

Yes, we see no reason to change. There are very valid reasons for continuing to treat storage and 'short-haul' differently, as explored in detail in recent NTS charging consultations.

Q5. Should the prevailing quarterly, monthly and daily entry capacity products, auction timings, and auction frequencies be changed or reviewed?

As stated above, if these proposals were ever to be implemented, additional within-day auctions for firm capacity must be introduced.

Q6. Removal of Discounts

a. **Should the discounts that apply to day-ahead (DADSEC) firm daily entry capacity be removed?**
b. **Should the discounts that apply to within-day (WDDSEC) firm daily entry capacity be removed?**
c. **Should a revised calculation for day-ahead (DADSEC) and within-day (WDDSEC) firm daily entry capacity apply such that both prices (p/kWh/day) are equal to the rolling monthly auction reserve prices?**

No, for the reasons outlined in this response, above.

d. **Should the zero reserve price that applies to daily Interruptible entry capacity (DISEC) be retained?**

Yes, for the reasons outlined in this response, above.

Q7. UNC Changes

a. **Should the calculation of the Daily Interruptible NTS Entry Capacity quantity released be reviewed?**
b. **Should Daily Interruptible NTS Entry Capacity at each ASEP be limited to when the firm entry capacity at the ASEP has sold out or is close to selling out?**

No, for the reasons set out above.

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c. **Should the revenue from the sale of within-day obligated NTS Entry Capacity continue to be redistributed via the entry capacity neutrality mechanism?**

The mechanism is the most appropriate means, but it should be recognised that removing the discounts is likely to result in a substantial increase to the already generally positive smear that takes place each month, inevitably benefitting those with the greatest share of neutrality.

Q8. Licence Changes

a. **Should the Licence clearing obligation be removed?**

If it is agreed that removing the discounts is the right thing to do, then it is our understanding that this would be required to avoid NG NTS breaching its Licence.

b. **Should the revenue from the sale of within-day obligated NTS entry capacity continue to be treated as SO revenue or should it be treated as TO**

We see no reason why it should be treated as anything other than SO revenue. Any change would be an arbitrary re-distribution of funds.

I hope that the above comments prove useful. Should you wish to discuss our response in any further detail, please do not hesitate to contact me on T: 02476 181421.

Yours sincerely,

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