Merrill Lynch

Global Markets & Investment Banking Group

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Mr. M. Berrisford
Joint Office of Transporters

Dear Mike

Response to UNC Modification 0037: Limitation on offering for sale unsold capacity

Thank you for the opportunity to comment on modification proposal 0037. Merrill Lynch Commodities (Europe) Trading Limited (MLCE) has a number of concerns with the proposal which are outlined below.

Transco appear to want a change that allows it to avoid meeting its obligations where in its view circumstances become difficult or where it assesses there is a risk of capacity buy back. Neither of these circumstances appears to represent a strong enough case for Transco to shift risk from itself to the shipping community. MLCE does not support this modification as Transco have not shown why its risks are now greater, and why this solution better facilitates the relevant objectives.

For the first criteria:

- *Transco NTS assesses there is a significant risk that it will not be able to physically deliver all or part of the unsold capacity from the capacity allocation date. This would typically be caused by the length of time required to obtain consents or construction challenges, both of which may be beyond the full control of Transco NTS.*

Transco seems to be describing the normal risks involved in infrastructure projects. This is one of the reasons why it is allowed a period of up to three years to deliver on incremental capacity builds. If Transco is unable to meet the baseline entry capacity then it needs to demonstrate to the industry what factors have changed to increase the risk of non-delivery. This proposal provides no rationale for why Transco would not be able to meet its baseline obligations and therefore no reason to curtail the sale of capacity.

Further, the proposal notes that shippers would be informed of curtailed sales at the auction invitation time, or 12:00 ahead of the day for the daily auctions. This timing does not match with the first criteria, as project planning and construction delays will be known well in advance of any auction procedures. If this modification is approved Transco should have to provide far more information on delays and problems so that shippers are able to better assess the likelihood of curtailment to capacity sales.

For the second criteria:

- *Transco NTS assesses there is an expectation that previously allocated capacity at the ASEP would need to be bought back.*

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It is difficult to understand why this criterion necessitates curtailing the sale of unsold entry capacity. The buy-back risk has already been incorporated into the risk reward framework negotiated by Transco at the last price control. Attempting to change this prior to the next price control requires a higher level of evidence that the system is unmanageable.

Reasoning that with an expectation of buy-backs, shippers will be encouraged to buy unsold capacity in order to benefit from Transco's stress is quite implausible for a sustained period of time. Firstly, if this scenario was in any way believable, a competitive market would increase the cost of unsold capacity toward the cost of buy-back in order to eliminate the arbitrage. Secondly, playing an entry capacity game with Transco has a number of risks for shippers. Transco will know whether a shipper intends to flow gas against this capacity. Should a shipper not have any gas to flow then Transco are more likely to be able to fulfil its other firm entry capacity obligations by allowing the value of 'gas-less' capacity to expire.

If a shipper buys capacity and has gas to deliver, there are a number of costs associated with switching delivery to other entry points (something many could not even do). These costs are likely to outweigh any potential benefits of selling capacity back to Transco. Such shippers would also need to compete with other capacity holders to sell capacity back.

We are puzzled by why Transco considers that its risks have suddenly shifted. Changing flow patterns on the system may imply a need for greater investment and reinforcement to meet some baseline capacity levels, but Transco have not raised this (or anything else) as a reason for the increased risks. It appears that shippers must simply accept that less flexibility is a good thing for the industry.

MLCE considers that Transco have not provided a strong enough case for this modification. It is seeking to shift risks from itself to shippers based on weak criteria that rely on Transco assessment. The risk on shippers increases as they will be less able to tell when capacity will be made available outside of the long term auctions.

Overall this proposal does not better facilitate the relevant objectives, as the buy back risks appear overstated and Transco have not demonstrated why these risks have suddenly increased. The proposal shifts risks from Transco to shippers in a way that forces more shippers to buy capacity in the long term auctions rather than being able to manage portfolios by a mix of long and short term capacity release. The shift of focus toward long term auctions will discriminate against some shippers and reduce the level of competition between shippers.

MLCE considers that there are already sufficient measures in place that allow Transco to manage unexpected problems from planning and building new infrastructure and that any significant issues should be discussed with Ofgem. Further, Transco should state why the risk levels have changed and why other solutions such as using the next price control to reset the baseline levels or re-negotiate its incentives are not preferable to introducing discriminatory solutions that increase the risk and uncertainty for shippers.

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