

CODE MODIFICATION PROPOSAL No. 0042
"Revision of the Emergency Cash-out Price"
Version 1.0

Date: 03/08/2005

Proposed Implementation Date: 01/09/2005

Urgency: Urgent

Proposer's preferred route through modification procedures and if applicable, justification for Urgency

(see the criteria at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752_Urgency_Criteria.pdf)

This modification proposal addresses important issues, which Ofgem, in their decision letter to modification proposal 021 'Revision of Emergency Cash-out Arrangements', considers needs to be addressed ahead of this coming winter. In response to this and to ensure sufficient time for the industry to put in place appropriate arrangements for this winter, E.ON UK is of the opinion that this Proposal should be treated as Urgent.

Nature and Purpose of Proposal (including consequence of non implementation)

This proposal seeks to amend the current Emergency Cash-out price from the prevailing single price of the 30 day average SAP to a single price of the prevailing SAP.

We have raised this Proposal to address the perceived issue that the current Emergency Cash-out price does not provide the most appropriate incentives on Users to make suitable provision to avoid entering into Gas Deficit Emergency (GDE). This Proposal seeks to provide the appropriate incentives on Users to address this concern.

In response to industry concerns raised in representations to modification 021, we consider that this proposal strikes the appropriate balance between the proposed emergency cash-out prices in modification 021 and the current single cash-out emergency price of 30 day average SAP.

In Ofgem's decision letter to modification proposal 021, two key areas were identified:

- **The need to ensure that there are appropriate incentives to encourage Users to take appropriate actions, through which as GDE might be avoided, or its duration or extent reduced.** Setting the emergency cash-out price at the SAP on the day provides the appropriate incentives for shippers to balance their inputs and offtakes, leading up to an emergency.

When considering different emergency cash-out prices, such as the current 30 day average SAP and the dual price, suggested in modification proposal 021, the SAP on the day emerges as the most pragmatic option for setting the emergency cash-out price. GDEs may be rapid or progressive, and where rapid, setting the emergency cash-out price at SMP Buy could penalise Users, where the shipper may not have time to react to improve its imbalance position and thus avoid an emergency, the imbalance price paid would, therefore, be disproportionate. This proposal ensures that Users are not exposed to extremes but at the same time are suitably incentivised to take action to prevent a GDE from occurring.

The SAP reflects a fair market value of the gas and will reflect the tightness of the market but, where a sudden price spike occurs, such as following a major failure of a terminal, those Users, who are short, would be unduly discriminated against through a penal cash-out price if the buy price was set at SMP Buy. Only a small volume of energy could lead to setting the SMP Buy, which could potentially lead to shipper failure.

The SAP is transparent and brings a fair reward for Users which are long and provides an appropriate incentive to those Users, which are short.

This proposal has further advantages of reducing the number of claims where a User believes that it will suffer a financial loss by reason of being paid only the relevant price. This financial loss should be minimised through a more market reflective emergency cash-out price, rather than the 30 day average SAP.

- **Whether the 30 day average SAP was high enough to incentives price sensitive gas to flow to the UK when a GDE has been declared.** We do not consider that any proposal, which seeks to incentivise price sensitive gas to flow to the UK when a GDE has been declared, through altering the emergency cash-out price, can have any significant affect with regards to price sensitive flows, such as the interconnector. Experience of late February and March of this year suggests that where the price of gas in the UK was such that short term financial gains could be realised, the interconnector remained exporting to the continent. We believe that this is owing to the long-term value on the continent associated with commitment to customers in ensuring their supplies are maintained. We have not therefore, sought to address this concern, through this modification proposal.

Furthermore, the NEC can request, via Transco NTS, the cooperation of interconnectors to prevent a potential or actual supply emergency occurring. We would argue that this provides sufficient provisions to ensure that the interconnector does not unduly export gas from the UK to the continent in the run up to an emergency.

Basis upon which the Proposer considers that it will better facilitate the achievement of the Relevant Objectives, specified in Standard Special Condition A11.1 & 2 of the Gas Transporters Licence

Implementation of this proposal would better facilitate the following relevant objectives:

1. (e) the provision of reasonable and economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic consumers, through ensuring the appropriate arrangements are in place to incentive shippers / suppliers, where they have the time and information to react to market signals, to avoid entering into a Gas Deficit Emergency (GDE) and thus minimising the probability of threatening domestic customer supply security.

1. (d) (i) the securing of effective competition between relevant shippers and (ii) suppliers, through targeting cost during an emergency thereby encouraging Users to take appropriate actions to avoid a GDE. Such actions might promote greater and more effective competition between shippers and suppliers.

Any further information (Optional), likely impact on systems, processes or procedures, Proposer's view on implementation timescales and suggested text

Proposed timetable:

Sent to Ofgem requesting Urgency	03/08/2005
Ofgem grant urgent status	04/08/2005
Proposal to be discussed at transmission workstream	04/08/2005
Proposal issued for consultation	08/08/2005
Close out for representations (5 working day consultation)	15/08/2005
FMR issued to Joint Office	22/08/2005
Ofgem decision expected	31/08/2005

Code Concerned, sections and paragraphs

UNC TPD Section Q 4.2.3

Proposer's Representative

Christiane Sykes (E.ON Uk plc)

Proposer

Christiane Sykes (E.ON Uk plc)

Signature

.....