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**Response to UNC Modification Proposal alternative 0071 and 0071A
“User Compensation for NEC Storage Curtailment”**

Dear John

E.ON UK does not support 0071 but does support alternative 0071A.

E.ON UK as the proposer of Modification 0052 is of the view that that both the form and level of compensation provided for under Modification 00052 is fit for purpose for this winter 05/06 and that any necessary refinements to address Ofgem’s reservations set out in their decision letter of 2 December, would be best considered by the industry next spring.

We were therefore very disappointed to see that NG NTS has found it necessary, with such undue haste to put forward Modification proposal 0071. In our view this proposal not only fails to address Ofgem’s reservations over Modification 0052, but also reintroduce the perverse incentives on shippers to deplete stocks of gas in store at faster rates than otherwise be the case.

Despite the fact that NG NTS recognise the core purpose of Modification 0052 is *“to ensure Users whose storage withdrawals have been curtailed as a result of the actions of the NEC are kept whole”* they go on to set out a proposal that would, in our view, more often than not systematically under compensate storage users. This is because the compensation value proposed by NG NTS does not consider the likely imbalance exposure (i.e. System Marginal Buy Price) faced by shippers who are subject to storage withdrawal curtailment.

Nor does Modification proposal 0071, properly value the gas in store after the emergency has ceased. It appears to consider that a pre-emergency Average Summer SAP value less 0.0611p/kWh is a suitable value for gas in store post an emergency.

In contrast the alternative proposal (0071A) seeks to provide **full and fair compensation** to shippers that find themselves less able to balance their positions in an emergency. It does this through a post emergency adjustment to the ‘up-

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front' (SMPbuy – 30 day SAP) 0052¹ compensation payment. This adjustment seeks to reflect the value of the curtailment quantity gas a shipper continues to hold in store based on spot wholesale prices post an emergency. Such a 'market related' value would mean the compensation paid to shippers would vary depending on the time of year the emergency ceased.

This allows shippers during an emergency to take a view on when such an emergency may cease, and therefore the level of compensation they may ultimately realise from storage curtailment. If they believe storage curtailment may end during winter this may influence the extent to which they may wish to claim curtailment quantities during the emergency.

By retaining the reference to SMPbuy in the compensation calculation, alternative 0071A ensures that an affected shipper will not face high imbalance cash-out exposures simply because there is a large difference between SMPbuy and SAP in an emergency. By referencing SAP, NG NTS's original 0071 proposal can never hope to provide the right compensation to cover a shipper's imbalance exposure in the event of storage curtailment.

Alternative 0071A sets out a number of possible realistic scenario under which different levels of compensation might be paid under 0071 and 0071A.

| Scenario | Compensation | |
|---|----------------------|---|
| | NG NTS Proposal 0071 | E.ON UK Proposal 0071A |
| A 'rapid' emergency ending in January | Too low | Broadly reflective of value of gas in store |
| A 'rapid' emergency ending in April | Too low | |
| A 'progressive' emergency ending in January | Too high | |
| A 'progressive' emergency ending in April | Too low | |

We consider that 0071A will improve *"the efficient and economic operation of the pipe-line system"* by avoiding inappropriate 'smearing' of compensation costs across all shippers where this is not justified, Inappropriate targeting of such costs may ultimately affect how shippers act in the market. This may indirectly impact shipper incentives to balance. This alternative will also improve *"the provision of reasonable 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 customers"* by providing **full and fair compensation** to Users affected by a storage curtailment, it will encouraging such shippers to maintain adequate stocks of gas in store to maintain supplies to such customers. As illustrated in the above table we do not consider this to be the case under all circumstances for the original proposal 0071.

In addition E.ON UK considers that the full and fair compensation to shippers affected by storage curtailment will help in *securing effective competition between relevant shippers*. In particular, it is our view, that shippers will be encouraged to use other forms of perhaps less economic flexibility in preference to storage under 0071, because they are not appropriately compensated for helping the system when the NEC requires shippers to keep gas in store. Ultimately this may help damage the prospect for further investment in storage capacity which the GB so desperately needs to support long-term security of supply.

Shippers are nevertheless acutely aware of their wider obligations to customers, which may lead them put a brake on how fast gas stocks are reduced. It would be wrong for prudent shippers who have chosen to rely heavily on storage capacity to meet peak supplies to customers to be unduly discriminated against, just because less prudent shippers have decided to withdraw gas from storage at much faster

¹ The actual 0071A compensation is made via a direct payment (as per 0071 original) rather than an adjustment to a shipper's energy balance position under Modification 0052.

rates. By addressing the perverse incentive that penalises shippers from maintaining adequate stocks of gas in store, prudent shippers are less disadvantaged than before. Thus implementation of the alternative proposal 0071A rather than the original 0071 will promote greater and more effective competition in the shipping and supply of gas.

It is important to note that under a number of realistic emergency scenarios NG NTS's proposal will also reintroduce the perverse incentives in the regime that were largely mitigated by the implementation of Modification 0052

The recent period of high gas prices has resulted in several shippers going out of business, in part because of their inability to cover their imbalance exposure. Failure to **fully and fairly compensate** shippers for storage curtailment under 0071 could in future very easily contribute to further business failures that might otherwise be avoided. This may be considered to be detrimental to competition in shipping and supply. Provisional 'up-front' (SMPbuy - 30 day SAP) payments under alternative 0071A helps ensures adequate cash-flows can be maintained to help avoid extreme imbalance exposure as a result of storage curtailment.

In the light of the above comments we urge the Panel to recommend alternative 0071A in preference to 0071.

Yours sincerely

Peter Bolitho