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Dear Tim,

**RE: Urgent Modification Proposal 0138 – “Transitional Arrangements for Entry Capacity Transfers to Sold Out ASEPs”**

As the Proposer, E.ON UK **supports** implementation of Modification Proposal 0138.

We are pleased Ofgem has indicated that this Proposal merits urgent industry attention. We consider that this is a key issue which, if not addressed quickly could lead to sterilised capacity at certain ASEPs, ultimately affecting a User's ability to bring competitively priced gas into the country; particularly affecting winter 2007. Equally, if this Proposal is not implemented, there will be on-going uncertainty surrounding possible future arrangements which may result in higher forward prices for next winter and the resultant risk that consumers may see, as a result, higher prices.

To date, National Grid NTS have been unable to demonstrate that they can deliver a sold capacity transfer mechanism following the 2007 AMSEC auction. We consider that there is a strong case, as outlined in the Mod Proposal, for not deferring implementation of a sold capacity transfer process and that Users need sufficient notice of actual change ahead of the 2007 AMSEC auction. An indicative implementation date from National Grid of October 2007 (for their draft proposals) for sold capacity transfers is not soon enough and fails to meet the pressing needs of the market. It is imperative that market participants are able to plan ahead to ensure gas supplies can be delivered where demand exceeds the baseline capacity of an ASEP, well before winter 2007.

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It is in the best interests of UK security of supply that Users are able to resolve any problems that may have been exacerbated by reduced entry capacity baselines, and can optimise their own portfolios as early as possible. Forcing market participants to leave such important decisions until the start of winter is counter-productive and could lead to inefficient decision making.

### **Transferring Sold Capacity ahead of Unsold Capacity**

If capacity transfers were approached holistically and from scratch, it can be well argued that the most efficient approach is for the annual capacity auction and transfer process to proceed in the following order:

1. AMSEC auction
2. SCTP (sold capacity)
3. AMTSEC auction (unsold capacity)

As highlighted in the Modification Proposal itself, the main advantages of transferring sold capacity ahead of unsold capacity are:

- The Sold Capacity Transfer Process will allow the transfer of capacity from any other ASEP, not just those that have unsold baseline, and thus the AMTSEC, if initiated before the Sold Capacity Transfer Process, may miss the most efficient ASEP (i.e. with highest transfer rate);
- Avoids reducing the available unsold capacity at the Donor ASEPs available for purchase in the within-year auctions – the AMTSEC will likely just result in further ASEPs becoming sold out.
- Allows Users to optimise their own portfolio before entering the market for unsold capacity and thereby removes an artificial, inefficient restriction on market participant's ability to trade both types of entry capacity, pre-winter 2007.
- Overall, this will ensure a more efficient allocation of capacity by allowing more scope for market participants to determine at which ASEPs they most want to hold capacity, thereby optimising use of the transmission system.

Mod Proposal 0138 is aiming to reinstate the possibility of this approach through transitional arrangements which would result in a sold capacity transfer process taking place soon after completion of the 2007 AMSEC auction, and before the proposed AMTSEC auction begins. Now that the new (and in many cases unexpectedly lower) baselines have been implemented into NG's licence, it is imperative that a sold capacity transfer process is in place as soon as possible to secure the continued and efficient delivery of gas onto the system.

## **The Sold Capacity Transfer Process (“SCTP”)**

Modification Proposal 0138 has a deliberately narrower focus than NG’s previously presented draft-only “enduring” sold capacity trading mechanism. Mod 0138 allows transfers of capacity between two ASEPS, but within one User account only, in order to maximise simplicity and aid rapid implementation. This Mod Proposal builds on existing processes and systems (namely Gemini) to facilitate, via NG’s exchange rate mechanism, the transfer of capacity between ASEPs.

The SCTP has been deliberately designed in this way to address a specific industry problem – i.e. to re-allocate capacity holdings to sold-out ASEPs, which for many Users is a critical issue now that many baselines have been reduced. The SCTP is also based broadly on National Grid’s model for the AMTSEC auction (Mod 0133), with the obvious exception that no “auction” arrangements apply. Broadly aligning the processes between unsold and sold capacity transfers should maximise a User’s ability to act efficiently.

## **Interaction with Future Capacity Auctions**

Although Mod 0138 would introduce a further process into entry capacity arrangements, we consider that the benefit in affording Users the opportunity to reallocate or optimise capacity holdings on a competitive, non-discriminatory basis, than would otherwise be the case, justifies the creation of an additional process. Operation and experience of these transitional arrangements could also help NG with development of a more comprehensive, enduring solution, which should still continue regardless of this Proposal.

As Ofgem also points out in their letter granting Urgency, implementation of Mod 0138 will likely influence User behaviour in the forthcoming AMSEC auction scheduled for May. On this basis, it is important that Users have notification of an impending change to the capacity allocation arrangements as soon as possible. To this end, we welcome Ofgem’s intention to make a decision on this Proposal ahead of the 2007 AMSEC auction. If Users are not afforded notice of this change pre-AMSEC, there is a real danger that inefficient and uneconomic decisions could be made in the May auction.

We do not consider that there will be any adverse effects from Modification Proposal 0138 on long-term auction signals to NG. It should be remembered that these are transitional arrangements with a deliberately narrow and limited focus to resolve current outstanding difficulties with capacity holdings at sold-out “recipient” ASEPs.

## **Issues Raised at the April Transmission Workstream**

### ***Ex-ante exchange rates***

NG raised concerns that publication of *ex-ante* exchange rates under Mod 0138 could be problematic for them. In response, E.ON UK believes that if exchange rates were not published, Users would simply have no idea whether a proposed ASEP to ASEP transfer could be efficiently realised through the SCTP process. This would inevitably result in more Users pulling out of the SCTP, after paying the process fee (and NG has incurred costs), when NG relay the news to the User that the exchange rate is poor or not what the User may have expected. Setting out exchange rates early on gives the market robust information about how participants can act most efficiently, and adds significant certainty.

It is extremely important, that Users are able to understand and manage their risks early on and publishing *ex-ante* exchange rates is one key way that NG can help achieve this. It could be argued that the setting of the new baselines under TPCR appeared to include many “high-level” assumptions and use of pro-ration. With this in mind, we find it difficult to comprehend why a capacity transfer mechanism has to be such an apparently precise science. Overly complex rules and procedures will simply discourage Users from participating in any capacity transfer or trading process, which will defeat the very purpose of it. Equally, capacity transfer exchange rates ignore the practical reality of how much gas is actually flowed on the day, which will ultimately have a much greater effect on actual operation of the NTS. In contrast, we believe Mod 0138 is a deliberately simple, straightforward, market-driven process.

### ***“Data-fixing” Gemini***

We do not consider that NG’s concerns about “data-fixing” Gemini are sufficient to warrant a current delay of five months to the proposed implementation date of a sold capacity transfer mechanism. Given the obvious urgency of the issue, and the fact that that these are transitional arrangements where few (but nonetheless highly significant) capacity transfers would take place during a one-day window, then we believe “data-fixing” is warranted. The real reason for delay on the sold transfers seems to stem from the fact that the administrative process with xoserve was not begun by NG at the same time as that for unsold transfers, and aside from this oversight, there would otherwise be no reason to delay implementation until October 2007. Whilst it is naturally important to follow due process, the benefits which implementation of this Proposal would reap in terms of increased security of supply and market optimisation far outweigh any temporary administrative hurdles faced by NG and/or xoserve.

### ***Revised NG Proposals***

E.ON UK recognises that National Grid has, since the March Workstream, shifted significantly from its position at the February Transmission Workstream, where it

presented draft proposals for a “full” sold capacity trading mechanism – i.e. trades concurrently between ASEPs and Users. Although we are pleased to see that NG sees many merits in Mod 0138, we would express concerns that what it is now presenting is effectively little more than E.ON UK’s transitional arrangements. The transitional arrangements seek to resolve a specific issue – i.e. provide additional capacity within nodal maximum at sold out ASEPs following baseline reductions. We consider there is appetite in the industry for a more comprehensive solution in the longer term, which builds on the transition arrangements, but offers more flexibility in terms of multiple ASEP and User combination trades. In the interim, however, Mod 0138 offers a simple solution to a pressing and real industry problem.

It should be remembered that there is no alternative currently formally raised by NG or indeed any certainty of a Modification Proposal being raised (or indeed implemented) before winter 2007. On this basis we would invite market participants to consider whether this Modification Proposal (regardless of any possible future option for an enduring solution) better facilitates the relevant objectives than the *status quo*.

### **Extent to which the Proposal Better Facilitates the Relevant Objectives**

E.ON UK considers this Proposal would, if implemented, better facilitate the following Relevant Objectives as set out in National Grid NTS’s Gas Transporters Licence:

- In respect of Standard Special Condition A11 paragraph 1(a), the Proposal would provide Users at sold out ASEPs the opportunity to seek to transfer sold capacity from other ASEPs. This will result in the avoidance of sterilisation of capacity and stranding of gas offshore, and thereby better facilitate the efficient and economic operation of the NTS pipeline system;
- In respect of Standard Special Condition A11 paragraph 1(c) (the efficient discharge of the licensee’s obligations under this licence), the Proposal meets new Licence obligations on National Grid NTS to facilitate the transfer of sold capacity between ASEPs;
- In respect of Standard Special Condition A11 paragraph 1(d), the Proposal would promote the securing of effective competition between relevant Shippers by making more capacity available at ASEPs that have been sold out;
- By giving greater scope to market participants to determine at which ASEPs they most value holding capacity, Users are able to make more efficient choices as to their use of the system and this will in turn help facilitate bringing the most competitively price gas to market.

If you have any questions or queries regarding this response, please do not hesitate to contact me on 02476 181421.

Yours sincerely

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