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Dear Tim,

RE: Modification Proposal 0149 / 0149A – Gas Emergency Arrangements: Keeping the OCM Open during a Gas Deficit Emergency

As proposer, E.ON UK **supports** implementation of Modification Proposal 0149A. We **do not support** Modification Proposal 0149. Of the two proposals, we believe that 0149A better facilitates achievement of the relative objectives.

We support keeping the OCM open during a NGS(GD)E, but we do not believe it is necessary to also change the current cashout arrangements. The primary objective in Mod 0149 – to have a daily, so-called 'dynamic' cashout price in a NGS(GD)E – may have severe adverse consequences on the ability of the market to recover from an emergency, potentially leading to shippers getting into financial difficulties. During the 2005/06 winter a number of smaller shippers went out of business because of very high wholesale gas prices. Any shippers finding themselves 'short' in an emergency against a backdrop of rapidly escalating 'dynamic' cashout prices could face multi million pound exposure. Failed businesses pass on their imbalance debts and customers to the remaining shippers which would have knock-on financial consequences for those shippers. Complete market failure could follow.

Whilst we agree with the need to provide appropriate incentives for shippers to balance, such incentives can only work if shippers have the ability to respond. In a NGS(GD)E, the normal market arrangements can reasonably be considered to have 'failed' or at least partially 'failed'. Introducing further mechanisms intended to stimulate certain behaviour (such as dynamic cashout prices, as per Mod 0149) are a distraction to the main task in hand, namely the collective safe management of limited gas supplies according to the Gas Safety Management Regulations.

In terms of the specific proposals, we offer the following comments:

Advantages of Modification Proposal 0149A

- The financial risk on Users would not increase as the imbalance cash-out prices remain ‘frozen’. In fact, the additional route to market would help Users better manage their imbalance exposure.

- Keeping the OCM open provides another route to market for shippers which (within the major constraints of the emergency situation) may help facilitate some improvement in wholesale market liquidity which may help better facilitate competition between shippers.

- The continuation of ‘frozen’ emergency cash-out prices will ensure that market participants will have greater certainty with respect to imbalance cash-out exposures, enabling them to focus on their duty to co-operate with the NEC in accordance with the relevant Gas Safety Management Regulations, rather than seeking to mitigate an arbitrary financial exposure that some believe is likely to arise from the establishment of a so called ‘dynamic’ emergency cash-out prices.

- Parties that find themselves ‘short’ in an emergency will need to use all avenues available to reduce that ‘short’ position. By avoiding the imposition of ‘dynamic’ cash-out prices this Proposal may avoid exacerbating the financial woes of such parties. This will enable more parties to stay in business than might otherwise be the case, thus facilitating greater competition between shippers and in supply than might otherwise be the case once the full market arrangements have been restored.

- In the event that a premium price has to be paid to attract price sensitive gas sourced form outside UK jurisdiction and that this is greater than the ‘frozen’ SMPsell price (i.e. the prevailing SAP at the time the NGS(GD)E was declared) any excess would be claimable under the Section Q post emergency claims.

Disadvantages of Modification Proposal 0149

- Shippers that are subject to a very rapid emergency (e.g. a terrorist attack on a terminal) would become ‘short’ by no fault of their own. Any trades on the day will determine the cashout price – i.e. shipper-to-shipper trades, <u>not</u> the current marginal price of NGG’s actions. The severe supply shortages in a NGS(GD)E would drive prices extremely high, resulting in a cashout price that could easily result in financial failure of multiple shippers, with subsequent “domino” effect.

- If a party seeks to obtain price sensitive ‘merchant’ gas from outside the UK jurisdiction this is likely to set a higher cashout price and exacerbate his already significant financial exposure.

- In an Emergency, normal market conditions do not apply - financial incentives to balance only work if Shippers have the ability to respond.

- Keeping the OCM open but also changing the cashout arrangements as proposed under Mod 0149 could act as a disincentive for shippers to use the OCM as a means to balance in an emergency situation, which is clearly contrary to the intention of both Proposals.

In summary, we believe that implementation of Mod 0149 could have far-reaching detrimental effects on the ability of the market to recover from a Stage 2 (and beyond) gas emergency. Consequently, we advocate implementation of Mod 0149A which does not seek to change the existing cashout rules, but does provide an additional route to market for shippers that could prove valuable in an emergency situation.

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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