



Tim Davis  
Joint Office of Gas Transporters  
51 Homer Road  
Solihull  
West Midlands  
B91 3QJ

**E.ON UK plc**  
Westwood Way  
Westwood Business Park  
Coventry  
West Midlands  
CV4 8LG  
eon-uk.com

Richard Fairholme  
+44 (0)2476 181421

richard.fairholme@eon-uk.com

Friday, 20<sup>th</sup> July 2007

Dear Tim,

**RE: Modification Proposals 0156 & 0156A - “Transfer and Trading of Capacity between ASEPs”**

As Proposer, E.ON UK **supports** Modification Proposal 0156A. We offer **qualified support** only to National Grid’s Modification Proposal 0156. We have a clear **preference** for Modification Proposal 0156A.

Our rationale for raising Mod 0156A is to maximise the value of the proposed entry capacity trade and transfer process and make use of all available time pre-winter to resolve the significant capacity allocation problems facing many Shippers following implementation of the current Transmission Price Control package. E.ON UK has been heavily involved in the development of proposals for entry capacity trading and transfers throughout 2007. We believe that the current proposals reflect a considerable improvement over NG’s previous Proposals. We are pleased to see, for example, that many ideas put forward by E.ON UK and other market participants in previous Mod proposals, which aimed to maximise the value of the process to Users, have remained; e.g. a process confined to winter 2007 (Mod 0138), zone-based trade and transfers, fixed 1:1 transfers within zones and ex-ante exchange rates (Mod 150A / 151A). These are areas that Ofgem also appear to see merit in, which has been stated in subsequent letters of non-implementation of Proposals or industry Workstreams.

E.ON UK is, therefore, supportive of the aspects of NG’s Mod Proposal 0156 highlighted above. The ability for real, constructive benefits to be realised is, however, dependant on the extent to which the process is made available to Users. This raises two key issues for consideration:

E.ON UK plc  
Registered in  
England and Wales  
No 2366970

### Single round vs. two round Auction

1. As currently proposed by NG in Mod 0156, Users will face a one-shot, 'all or nothing' single round auction. This is unacceptable and introduces unnecessary risk and uncertainty into the market. Inevitably, risk premiums affecting customer pricing may reflect this perceived increase in risk to Users. Both in public and in private discussions, NG have acknowledged that more than one round pre-winter is possible and therefore it seems nonsensical *not* to make use of all available time, accordingly. As such, E.ON UK believes very strongly that more than one round must be made available to bidders in this auction. NG's "best endeavours" approach to running a further round (which is not part of their Mod Proposal) simply offers unacceptable uncertainty. Ideally, we would like to see even more rounds than the two presently proposed in 156A. However, based on our clear steer from NG and given the urgent need for a workable, realistic process to be implemented pre-winter, we recognise the need for compromise and would urge GEMA, in formulating their decision on both proposals to be equally pragmatic.

### Zonal Maximum

2. The key to the release of entry capacity through the trade and transfer process is the Zonal maximum figure. The level that this is set at will ultimately determine whether the process is a success or failure for Users. It is accepted that the Zonal maximum is a reflection of the physical capability of the 'zone' but that stipulating that it reflects the nodal maximum of all individual ASEPs at the same time is perhaps unrealistic and could lead to an increased buy-back risk. As the setting of the Zonal maximum is a NG discretionary practice, we would urge Ofgem to very closely monitor and audit (if appropriate) the setting of this level to ensure that it appropriately reflects both the capability of the network and the terms of the current TPCR. If the zonal maximum(s) is set too low (i.e. well below the "sold" level), we will see no (or very little) capacity transferred, regardless of the level of surrendered capacity, particularly at the Easington ASEP.

E.ON UK suggests that zonal maximum is set at least to, or as close as possible to, the zonal aggregated baseline and in exercising their discretion on this point (if either Mod is implemented), NG should pay due regard to the fact that zonal aggregated baselines was the basis on which National Grid's cost of capital was set in the TPCR and that NG have been earning

revenue from the incremental capacity sold at Garton which could be sterilised by a low zonal maximum in the Easington Zone.

It is also worth noting that the current lack of an accompanying Charging Methodology remains a substantial obstacle to Users understanding and being able to replicate these Proposals and certainly has not helped Users who have not been involved in the process as closely as others, to understand the full ramifications or at least ease some parties' concerns around perceived uncertainty. The lack of transparency on the development and current status of the charging methodology is major concern to E.ON UK.

**Extent to which the Mod Proposals better facilitate the relevant objectives:**

- In respect of Standard Special Condition A11 paragraph 1(a), either Proposal should provide Users at sold out ASEPs the opportunity to seek to procure available Capacity from other ASEPs (but largely reliant on NG's setting of the zonal maximums). This may result in the avoidance of sterilisation of Capacity and the 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 (in part, but to a satisfactory extent) new Licence Obligations on National Grid NTS to facilitate the transfer and trade of Capacity between ASEPs in the constrained period.
- In respect of Standard Special Condition A11 paragraph 1(d), Mod Proposal 0156A would promote the securing of effective competition between relevant Shippers by use of two rounds of a pay-as-bid auction for the allocation of any available Capacity and the use of *ex-ante* exchange rates. Two auction rounds for the key winter months would clearly better facilitate competition between Shippers than a single round, which could severely limit the value of the process to Users.
- Affords Users the opportunity to secure additional capacity, in excess of an ASEP's baseline, therefore allowing gas flows onto the system that may otherwise be prevented and may avoid the sterilisation of entry capacity. As a result, this Proposal better facilitates the relevant objectives under Standard Special Condition A11 paragraph 1(e), the securing of the domestic customer supply security standards.

### Advantages of Mod 0156A over Mod 0156

- Through provision of two auction rounds, better addresses Ofgem's previously stated concern that a "one-off" trade and transfer auction would not be satisfactory either as a temporary *or* enduring solution.
- Through the use of two auction rounds, would afford significantly more flexibility (than both Mod 0156 and the *status quo*) for Capacity to be reallocated to where Users value it most this winter, leading to greater certainty in the market.
- By providing for more than one auction round pre-winter, is a fair and equitable approach for all Users, which limits potential for unjust speculation and capacity hoarding, which could result from a single round, "one-off" auction.
- Introduces significantly heightened price discovery and transparency through the use of two auction rounds.
- In our view, Mod Proposal 0156A places wholly realistic demands on NG resources and accommodates pragmatically other resource demands such as the September QSEC and October RMSEC auctions. E.ON UK has also discussed and shared our ideas with NG NTS about multiple auction rounds with a view to developing an effective and realistic solution for the whole market.
- Maximizes all available time to extract the most value from the extremely important trade and transfer process.

For clarity, there is no interaction between trades and transfers as proposed by Mod 0156/0156A and the QSEC auctions. The latter auctions are making capacity months from 2009 available and since trades and transfer in this case only applies to winter 2007 months, there is no relationship or implications to consider from a User's perspective.

In conclusion, although we support some of the key aspects of NG's Mod (to the extent that it now reflects many positive ideas put forward by the industry), we consider that Mod Proposal 156A offers significantly more flexibility and value to the market and the potential benefits are therefore much greater – both than the *status quo* and Mod 0156. We also welcome Ofgem's on-going commitment to ensuring NG delivers in-line with its Licence obligations, pre-winter 2007.



Yours sincerely

**Richard Fairholme** (by email)  
Trading Arrangements  
E.ON UK