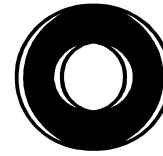


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MACQUARIE
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Mr. Julian Majdanski
UNC Panel Secretary
Joint Office of Gas Transporters
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06 June 2008

Dear Julian,

Re: Modification Proposal 216: “Introduction of an additional Discretionary Release Mechanism for NTS Entry Capacity” & 216a – “Introduction of Additional Pay-as-Bid Auctions for NTS Entry Capacity”

Thank you for the opportunity to comment on the above proposals relating to the additional release of NTS Entry Capacity. Macquarie Bank Limited (MBL) supports modification 216A but does not support modification 216 as it believes it represents too great a risk to the UK gas market.

MBL believes that where possible greater levels of entry capacity should be released by National Grid. Following investment or changes in the operation of the network, if National Grid (NGG) has the ability to release additional entry capacity then it is in the interests of consumers and market participants that it should do so. It is essential that any modification proposal ensures that the process used to release this capacity is open, fair, transparent and has limited market risk. If the process used to release the capacity fails to meet these principles then it is likely that distortions will be created that impact the market.

Market Impacts of 216

NGG’s modification 216 proposes a capacity release mechanism that is, through its bilateral nature, likely to create a duality of knowledge within the market. Users who request capacity would have greater knowledge regarding the likelihood of the release of capacity than the rest of the market. It should be noted that the market will make the reasonable assumption that the release of capacity will relate to physical gas entry.

A large alteration to the supply position with just seven days notice will undoubtedly surprise the market and increase price volatility. MBL has found it hard to quantify the likely impact of such a situation but suggests that gas prices would be seriously affected. Consequently the user who requests the capacity would be likely to take advantage of the duality of knowledge created by this proposal. By taking both physical and financial positions they can benefit significantly through the market reaction when NGG announces the capacity auction.

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It should be noted that Traders and Risk Analysts in the market would be unable to quantify the risk of the sudden, unexpected changes to the supply position the regime proposed under modification 216 would create. This kind of 'blind' risk leads to nervousness in markets which will either result in reduced liquidity along the traded curve or a high risk premium being built into the price. MBL believes that this reaction by the market is unlikely to be seen until after the market experiences its first unexpected change in the supply situation.

In industry discussions NGG has recognised and agreed that the risks identified in this response are created as a result of their proposal. NGG however has indicated that it is unwilling to amend its proposal to address these concerns. MBL suggests that as NGG is not exposed to the risks this proposal creates, it does not have any incentive to ensure its behaviour does not impact market participants.

MBL notes that the 28 day period in the E.ON proposal significantly reduces the risk of the market reacting to the surprise of additional capacity being released. It avoids capacity being released in such a way that surprises the short-term markets and therefore mitigates much of the risks identified with modification 216.

Market Signals as a result of 216/216a

In previous consultations and papers on the existing entry capacity regime Ofgem has indicated it is in favour of mechanisms that favour long term market signals. It could be argued that this mechanism undermines the existing regime as it potentially allows parties who failed to bid for incremental capacity avoid giving the appropriate signals and avoid competing against other participants at other nearby entry points.

MBL would like to further understand how the NGG proposal 216 would interact with the short-term entry capacity auctions as well as the Transfer and Trades process. It is unclear what safeguards would be put in place to ensure that this proposal and the Transfer and Trades proposal did not distort or compete with each other.

Fairness and Security of Supply

NGG has suggested that it needs to be able to release capacity at seven days notice to allow LNG cargoes to enter the UK at entry points where capacity may otherwise be unavailable. It has suggested that this is an issue of Security of Supply to the UK. MBL suggests that this logic is flawed.

In the event that the UK gas network was at risk of entering a Security of Supply situation and by good fortune an uncommitted LNG cargo happens to be nearby, then it seems unlikely that the situation will not be resolved within the seven day notice period. In the event it was not resolved by other means then it seems more likely that a Network Emergency would be declared. In the case of a Network Emergency being declared then MBL assumes that the NEC would have the option to direct the cargo to dock and flow its gas averting or curtailing the emergency.

Outside of an Emergency process, shippers with existing LNG commitments either have to book capacity in monthly periods or risk daily capacity being made available. This ensures a level playing field for all shippers. LNG shippers who want the security of knowing capacity will be available prior to the vessel passing its point of deviation to an alternative destination will have to buy capacity for the entire month in which they may want it. This proposal therefore puts shippers who book under this new regime at a competitive advantage to those shippers who have booked under the existing regime. Under the new regime they will only have to pay for the days that they want capacity.

MBL is especially concerned that this modification could be unfair on those shippers who have signalled appropriately for long term incremental capacity through the long term auctions. This is especially so when we consider that in many cases it will be these long term commitments which underpin the investment NGG makes in its network that leads to the release of further non-obligated capacity.

Despite suggestions to the contrary MBL believe that proposal 216a would facilitate the importation of additional LNG cargoes. The shippers purchasing the capacity for these cargoes would be able to buy capacity for the entire month in which they expected the cargo to be used. It appears a reasonable argument that by requiring the purchase of monthly periods of capacity proposal 216a ensures that there is a level playing field between those parties who have already purchased monthly periods of capacity through the standard auction processes.

Transparency

Both modifications fail to answer some fundamental questions around the transparency of the request process including how competing requests for capacity would be judged. Modification 216a has much greater transparency however as it is clear how the auction process would be constructed. MBL believe that it is important that as such transparency is included in any suggested modification rather than left for development at a later date.

Conclusion

In conclusion MBL believes that it is important that the impact of these proposals on the UK gas markets is considered and by this measure modification 216 presents a much greater risk to the market than modification 216a.

National Grid NTS' Gas Transporter Licence: Standard Special Condition A11 paragraph 1(d), provides an obligation to promote effective competition between relevant Shippers which MBL believes it fails to ensure adequately fulfil under modification proposal 216. MBL believes the lack of transparency in the capacity release process creates a division of knowledge between the shipper requesting capacity and the remainder of the market. This difference in knowledge is likely to create market distortions.

I trust these comments are helpful, if you have any queries regarding this response please contact me on 020 3037 4655.

Yours sincerely,

Gareth Roberts
Senior Gas Operator – Energy Markets Division

*please note as this letter has been delivered electronically a signature will not be attached