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Bob Fletcher
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Dear Bob,

RE: UNC 0349 - Introduction of a Force Majeure Capacity Management Arrangement

On balance, E.ON does not support implementation of this proposal. We agree that the current UNC provisions on Force Majeure (FM) are deficient by exposing Shippers to all the risk and whilst we fully support the principle of affected Shippers being appropriately compensated in the event of FM being declared by National Grid NTS (NG NTS), we do not believe the generality of Shippers at all other unaffected entry points should have to fund this; at least not until NG NTS's current capacity buy-back 'pot' of £13.5M p.a. has been exhausted.

Under existing, established arrangements, NG NTS can contract forward if it anticipates capacity to be constrained. To facilitate this, there is already a (rarely used) buy-back fund / target (£13.5M with SO incentive payments attached for outperformance) available to NG NTS. In circumstances where NG NTS cannot make previously sold capacity available, this should be the funding mechanism used first. The buy-back incentive is currently structured such that if costs exceed the target level, additional buy-back costs are then shared on a 50/50 basis between NG NTS and Shippers. As Ofgem clarified in 2009:

"The entry capacity operational buy-back incentive allows NGG to increase its System Operator (SO) revenue if it can contain the costs of buy-back of entry capacity. However, if

NGG incurs high entry capacity buy-back costs, then, other things being equal, the entry capacity operational buy-back incentive acts to reduce SO revenue....If NGG outperforms the incentive then it earns 50% (the sharing factor) of the difference between the target and the value of the performance measure, subject to a limit of £18 million (the cap)".[1]

Implementation of this Modification Proposal would ensure that NG NTS still has the opportunity to earn SO incentive revenue even where FM is called, since the buy-back incentive will be less affected than if NG NTS had to fund the buy-back of capacity itself (rather than sharing it with Shippers, as proposed here). We strongly question whether this acts as a sufficient incentive on NG NTS to resolve a FM event in a timely manner or indeed is even justifiable in the context. Although we recognise that this proposal goes some way to relieving Shippers of their current obligation to pay for capacity which they cannot utilise, it fails to address NG NTS's refusal to refund the cost of capacity entirely at its *own cost*. If NG NTS is willing to accept 50% of the "cost" of refunding capacity (as proposed here), we do not understand what the remaining 50% is actually paying for, and therefore why NG should be allowed to keep it.

As set also out in our response to Mod 262, we note that under current UNC TPD Section J 3.6, which deals with Force Majeure, Shipper's liability for exit charges is relieved after 7 days of FM being called by NG NTS. One alternative way of tackling the current UNC deficiencies, therefore, would appear to be to insert the word "entry" into this clause (or replicate it in the relevant UNC section dealing with entry capacity); thereby avoiding the need for a complex refund mechanism, as proposed here. Although this may be considered better than the current arrangements, unfortunately it would not address the impact on Shippers of an FM event which lasts less than 7 days.

Under this proposal, by using the Weighted Average Price of entry capacity at the affected entry point, Shippers operating at entry points where the reserve price is zero would receive no financial recompense where FM is called. This potentially causes disparity between entry points. For example, should FM be called at two (or more) entry points in a similar time frame, under this proposal the incentive would be on NG NTS to resolve the FM situation more quickly at the entry point where most cost is being incurred, by reason of a higher capacity reserve price. We do not believe this is correct, as it creates the potential for undue preference by NG NTS in treatment of entry points and by extension, Shippers. In reality, the true cost to a Shipper of capacity being constrained does not necessarily correlate with the reserve price of the capacity – hence, why under current arrangements (except where FM is

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[1] Ofgem, "*Review of entry capacity operational buy-back incentive and default incremental entry capacity lead time*", 26 November 2009

called) there is the facility for Shippers to place buy-back offers on Gemini, which allows them to price this in.

Overall, we firmly believe the current capacity buy-back mechanism remains the most effective means of dealing with FM. It is market-based, allows Users to price the cost of an FM event into their buy-back offer, and by imposing appropriate costs on NG NTS, promotes a timely resolution of the capacity constraint. We acknowledge that under the current UNC arrangements there is no obligation on NG NTS to buy-back any capacity in the event of FM, but the removal of this exemption would, in our view, be the most acceptable way forward in terms of maintaining an appropriate risk / reward balance between NG NTS and Shippers.

If you wish to discuss this response in any more detail, please do not hesitate to contact me on T: 02476 181 421.

Yours sincerely

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