

30 November 2006



Julian Majdanski
Modification Panel Secretary
Joint Office of Gas Transporters
Ground Floor Red
51 Homer Road
Solihull
West Midlands B91 3QJ

Dear Julian,

Re: Draft Modification Report 0090 "Revised DN Interruption Arrangements"

Corona Energy ("Corona") wishes to submit the following in response to the above draft modification report.

Introduction

Corona does not support the implementation of the Modification Proposal.

The Modification has been proposed as a result of the changes to the DN Licences as part of the DN sales process. We understand that Ofgem harbours concerns over the applicability of the current interruptible arrangements and has recorded its dissatisfaction in a number of documents. In general, it is difficult to disagree with the various weaknesses highlighted by Ofgem, but Corona believes that this proposal will only succeed in creating additional problems without fully addressing those which currently exist.

Corona wishes to establish that the purpose of the interruptible arrangements is to provide the DNs with access to constraint management tools. In the interests of generating efficiencies in both day to day operations and future capital investments it is reasonable that from time to time DNs have access to interruptible capacity at a Supply Point level. This principle clearly establishes the key relationship in the management of capacity constraint; between DNs and customers. In essence, this proposal attempts to create "User agent" processes to contractualise and administer this relationship. It is our firm belief, however, that due to its complexity and misjudgment of the workings of the supply market the proposal will create an environment of uncertainty, risk and restricted competition.

Corona believes that rather than seek to make unwieldy changes to the UNC, the industry would be better served, with regard to interruption for constraint management, to reconsider the relationship between Transporters and customers.

Critique of the Proposal

Corona has identified a number of weaknesses with the proposal and has detailed them below:

User/Market associated weaknesses:

- Interruptible contracts can only be entered into between the DN and the prevailing User at the time the tender occurs i.e. in most cases a minimum of 3 years prior to the commencement of the relevant contract period. On this timeframe, unless a long term contract has been entered into, then there is a high probability that the Supplier to that customer will change. This requires, therefore, that the incoming Supplier and subsequent Suppliers must inherit the terms entered into by previous Suppliers.

In the event that a Supplier agrees to enter into a supply arrangement with a customer at the expiration of the existing arrangement with an alternative Supplier then, assuming that the customer wishes to tender for future interruptible capacity at that time following the change of Supplier, then the existing Supplier must tender on its behalf. This requires that the customer, which is effectively offering services directly to the DN, must manage the contractual relations between current and future suppliers. This seems excessively complex and risky.

In the event that a customer does enter into an interruptible arrangement with a DN via its existing Supplier this can generate uncontrollable risks for any incoming Supplier;

- What happens if under the terms of the Supply Agreement with the incoming Supplier the customer "reneges" on its previous commitment to provide interruptible services? Corona assumes that as the commitment sits with the User then any failures by the customer to meet the commitments made on its behalf by the previous and therefore, current supplier, are recorded against the current supplier. Again, this furthers the argument that the contractual commitments should reflect the physical relationships.
- We assume and seek clarification in this regard, that in the event the customer is unable to meet its obligations due, for instance to bankruptcy, then the User, current or subsequent, is absolved of its obligations under the UNC to meet interruption requests?
- On the basis that interruptible agreements are struck far in advance of the contracted period it is possible that the terms entered into at the time of tender may not be suitable at the time of adoption. This is particularly true for companies which are energy intensive and/or heavily reliant upon performance in other markets in which they operate. In this instance, the Supplier may face excessive credit risk as failure to interrupt charges which may be applied may not be able to

be passed through to the customer. This problem is less likely to occur under the current rules where interruption is effectively only contracted for in the current Gas Year. Corona suggests that this level of risk and those detailed in previous bullets are likely to deter smaller Users from participating in this market.

- At the time of tendering for the supply of gas to customers it would appear that the User is reliant upon the customer to inform it of its commitments, made indirectly through current or previous supply agreements. The User is denied access to this information through the SPA route until such time as it wishes to confirm ownership of that Supply Point. In addition, we understand that the precise commercial terms of the commitment are not made available to the Supplier via this route. Again, this generates risks for Suppliers as, unless the customer wishes to reveal accurate information, then the User may be unaware of the commitment it has entered into with the relevant DN. This may not have a direct influence on the Supplier, except in the case of credit risk, as we would expect supply agreements to contain pass through elements for such services. It is highly plausible, however, that this may frustrate discussions around commercial interruption services if the customer is unable to share this information with potential suppliers.
- Corona is certain that these arrangements will limit competition between Suppliers and will move the industry towards longer term supply contracts. We would expect that a number of "smaller" suppliers would veer away from this market due to the amount of complexity, risk and additional costs associated with supplying this sector. In addition, and in order for Suppliers to realise some benefit from providing this extra service (where no direct benefit is apparent except to the DN) then we would expect them to only entertain such contacts on a long term basis i.e. in excess of three years.
- The above bullet is given further credence by the fact that it is highly probable that suppliers will seek to develop parallel commercial interruption rights to add value to the supply contracts. Such contracts which bundle interruptible rights are likely to be difficult to unbundle and further restrict supplier transfers. We would argue that incumbent suppliers will be at an advantage and will be able to lock in customers into long term deals which may, or may not be to the advantage of the customer.

Customer associated weaknesses

- Stranded assets are a clear concern for customers. In a number of cases interruptible services have been/will be offered only in the event that the customer has access to back up fuel. This fact brings a number of issues to our attention; firstly, is it fair that those customers which have invested in back-up facilities under the current rules should be required to write-off that investment due to a change in the UNC? These investments are likely to have payback periods greatly in excess of three years and in our view it is unacceptable that the costs of financing these potentially unused assets should fall solely on customers. Secondly, due to the transient nature of the contractual arrangements (anywhere between 1-5 years) it is unlikely that a

- customer will invest in back up facilities. Customers will not be certain that the investment in the facilities will be paid back over a reasonable period from the compensation payments received from the DN, via their Supplier.
- We would also bring into question the viability of investing in back up fuel when considering forthcoming changes to environmental regulations, in particular restrictions on emissions. Again, and in addition to the above considerations uncertainties relating to the value and potential utilisation of back-up fuel this issue will further deter customers from seeking to offer interruptible services at “reasonable” prices.
- At this stage it is unclear whether customers would be interested in participating in the tender process. Without a clear understanding of the financial benefits associated with offer capacity we are sceptical that the discounts provided will be sufficient to justify “turning down” consumption. This is particularly relevant when the balance between the costs of the gas commodity and transportation charges is considered. The issues associated with the above bullet are also likely to deter customers from entering into any medium/long term capital expenditure plans to facilitate reduced gas consumption which again will limit the availability of interruptible capacity.
- Similar to the timing issues raised in the previous sub-section we must remember that for the majority of customers at the DN level in particular, gas is a component part of a business’ overall operation e.g. a fuel supply used in production. Introducing complex arrangements which require precise quantification of future needs and the value of them is, in many cases placing unrealistic demands on customers. Our suspicion is that many customers will either not participate in the tenders or offer prices which are excessive (build in a comfort zone due to high levels of uncertainty). Both of these outcomes are likely to provide misleading signals to the DNs and potentially lead to over-investment and/or inefficient day to day management of the network.
- Finally, the potential for limited Supplier competition and the increased incidents of long term contracting are unlikely to benefit customers

DN Associated Weaknesses

- A number of issues highlighted above are relevant to DNs e.g. quantity of interruptible capacity offered; price of that capacity; and levels of competition in certain areas/zones. All of these weaknesses are likely to skew investment signals and potentially inflate the costs of constraint management.
- Corona does not have the confidence that the DNs will be able to predict precisely the volumes and location of their interruptible needs. At this stage, we have seen nothing from the DNs that they are capable of performing this task and we are naturally concerned that they are likely to over/under forecast their requirements. Our suspicion is that they will be conservative and will look to over-contract, assuming of course that customers/Users are willing to meet their demands! We understand that Ofgem will introduce incentives on the DNs to most efficiently manage their networks, but as is

always the case this requires that Ofgem has a good understanding of what is reasonable. Again, we have no evidence to suggest that Ofgem is well placed to independently determine what is a reasonable level of interruption, or what are reasonable levels of costs to manage constraints. Incentives which rely upon such inputs are unlikely to achieve the objectives which underpin their existence.

- Finally, and this observation relates to all Parties this proposal, without question, this Proposal is likely to lead to an acceleration in Network Emergencies. This is based on the simple logic that if interruptible capacity is restricted for all the reasons stated above then it is far more likely that firm loads will need to be curtailed to relieve a capacity constraint. We assume that the HSE will view this in a very dim light.

Modification Report Sections

Better Facilitating of the Relevant Objectives

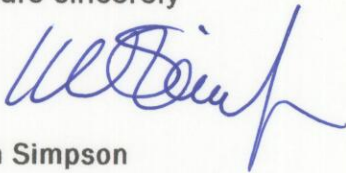
Corona believes that due to the reasons stated above the Modification Proposal does not better facilitate the Relevant Objectives:

- It will hinder the efficient and economic operation of the system for a variety of reasons stated above, and as summarised below;
 - DNs inability to determine precise interruptible needs;
 - Limited offerings by Users/customers;
 - Skewed investment signals.
- It will not aid in securing effective competition between shippers and suppliers, again as summarised below;
 - High risks of entering into arrangements on behalf of customers at least 3 years into the future;
 - Many Suppliers will be deterred from participating in this market;
 - Customers are more likely to be locked into long term contracts which will limit competition;
- We would argue that the arrangements are also likely to compromise Security of Supply as it is more probable that Emergency Procedures will be invoked.

As stated at the outset of this response Corona is firmly of the view that this Modification is rejected and the industry focuses on examining the potential for direct contractual relationships between customers and Transporters. Interruption for capacity constraint management is a pure transportation service and we see little merit in requiring Users to act as agents. It can be observed from the Proposal that this structure will only succeed in adding complexity and costs and in no way can be judged to be of benefit to UK customers

We trust you find our comments useful and if you have any questions then do not hesitate to get in touch.

Yours sincerely



Ian Simpson

Head of Operations

