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November 30, 2006

Dear Tim,

RE: Modification Proposal 0090 – Revised DN Interruption Arrangements

E.ON UK does not support this Modification Proposal.

In practice, we believe that the auction-based process for allocating interruption rights will lead not only to higher costs to end consumers, but through added complication, lessen the appeal of being interruptible; thereby leaving very few customers for Distribution Networks (DNs) to actually interrupt. The direct consequence would be a possible shortage of interruptible capacity, which could lead to firm load shedding becoming a much more easily realised and unwelcome scenario, as a result of more rapid progress through the stages of a gas emergency. Naturally, this is of great concern to E.ON UK and our Retail customers. We share the concerns of many parties that the proposed interruption arrangements could endanger the integrity of current emergency procedures and ultimately the safety of gas supply in the UK. We have summarised our key concerns about the proposals, below.

Gas Safety and Security of Supply

Changes as envisaged under Mod 0090 will mean that the UK is likely to lose an important tool in managing gas emergencies. We consider that, in practice, the complexity of the bidding process and finding an appropriate price to tender will dissuade a large proportion of customers from wishing to remain with, or gain, interruptible status. The DNs could, as a result, be left with a shortage of interruptible capacity and since the proposal relies on the economic “will” of customers to participate in the bid process, it seems impossible for DNs to plan ahead to manage this potential locational shortage.

In any event, a lack of interruptible capacity would simply move everyone one stage closer to a firm load shedding scenario under a gas emergency. Moreover, the implications of this are not limited just to national emergencies or peak winter demand, but as was demonstrated during a capacity constraint in the summer of 2003, widespread interruption was necessary in the south of England to avert the need for firm load shedding. This was not due to a shortage of supply of gas, but other factors, including offshore plant maintenance. Occurrences such as these may continue to present problems irrespective of current and planned infrastructure developments and insufficient interruptible capacity will compromise the effective management of similar unexpected situations.

From an economic viewpoint, the existing regime may be providing a cross-subsidy where customers with interruptible status enjoy the cost-saving benefits of paying no capacity charge, while firm customers pay extra to compensate for the reduced capacity charge income. This may be a particularly inefficient arrangement where the interruptible customer is infrequently interrupted. They are, however, still able to be interrupted and therefore rightly are compensated for the additional costs associated with being an interruptible, such as provision of standby by fuel and duel fuel capability. Notwithstanding, we estimate that under the current arrangements, the current “subsidy” per customer is small. For example, consumer groups have quoted average transportation discounts for being interruptible of less than one pence p/therm. If the UK interruptible market is estimated to be worth approximately 5,000 million therms/pa, then the cost per customer (based on 20 million end consumers) would be less than £2.50 per annum. A very small price to pay, we believe, for a substantial contribution to security of supply.

CHP Impact

The impact on CHP plant is also a relevant, but apparently ignored consideration for the proposed interruption arrangements. The direct impact on “merchant” CHP plant of going firm will be that BM prices will almost certainly increase. CHP is not plant that would normally operate at base-load so it is not beneficial to run it as firm. As a result, it would usually be commercially disadvantageous not to have the site nominated as interruptible. The key problem here arises where CHP plant is not required to be interruptible according to the new, revised DN requirements under Mod 0090. There is a significant commercial risk that such generation assets could potentially become potentially less viable if forced to operate as firm. Moreover, the direct impact of forcing CHP to operate as firm would be an almost inevitable pass-through of higher operating costs, resulting in higher Power prices and ultimately, potentially higher customer charges – all of which are unwelcome.

By its very nature, CHP plant is also a very useful, flexible asset in respect of interruption and contributes a significant resource where rapid demand-side response is required. As a result, we consider that CHP plant and its role within interruption arrangements has not been sufficiently considered by this Modification Proposal and would urge Ofgem to consider this issue further.

Safety Case

We would question whether all of the Transporters have prepared a sufficiently robust safety case backed up by the appropriate knowledge and resources to accommodate Mod 0090. Also, it would appear that the Safety Case will have to change to accommodate this Modification although we understand that the National Emergency Coordinator (NEC) is following this up with the Transporters and the HSE and we would expect, *if* this unwelcome Mod is to be approved, that all Safety Case concerns had been fully addressed and resolved.

Overall, given our considerable concerns around security of supply and safety, we do not consider that this proposal would further the relevant objectives under Standard Special Conditions (SSC) A11.1 (a), (b), (c) and (e).

The Cost to End Consumers

We consider that a minimum of three years is not an appropriate period of time to be bidding for interruptible rights. It is not realistic in the current climate to consider that a customer will remain with a shipper for three to five years. With this in mind, we find it difficult to contemplate investing substantial time and resources into preparing and submitting bids to cover such a long period away in the future, when customers can and will switch supplier at any time. Equally, the contract that transfers with the customer could also conceivably be used gain unfair insight into competitor bidding strategies and practices, which may ultimately distort competition between suppliers, contrary to SSC A11.1 (d) (ii).

Furthermore, if the costs of formulating a strategy and bidding for interruption are passed through to customers, some of the financial benefits for the customer of becoming interruptible will be negated. We believe that an “open tender” approach, which is favoured by the DNs, would be the most expensive and time-consuming process for shippers and customers. As a result, in order to minimise the financial impact to customers, if these unwelcome Mod 0090 proposals *were* to be implemented, we would strongly favour an administered price format.

If an “open tender” approach was, however, adopted, we believe that, contrary to the current proposals for Mod 0090, it would be extremely useful for transparency purposes if the DNs published the “likelihood” of interruption. This piece of information is likely to be pivotal in formulating an accurate and cost-reflective bid for interruption as it will dictate the price a customer is willing to pay for the right. Where there is a small chance of interruption very little immediate financial benefit is afforded to the customer who chooses to be interruptible and therefore, the bid is likely to be low in order to reflect this. We would urge the DNs to re-consider making this information readily available to users in order to help procure the kind of bids that they require and to minimise time spent by Shippers on inappropriate bids.

Further to all of the points in the section above, we do not consider that this Modification Proposal, as currently drafted, furthers the relevant objectives concerning the securing of effective competition between Suppliers under Standard Special Condition A11.1 (d).

Stranded Assets

Stranded assets are a genuine concern for some of our customers, who have invested heavily in alternative fuel supplies to allow them to respond more readily and continue their operations when interruption to their gas supply is required. Our main concern on this issue is that by publishing their interruption requirements, DNs may exclude some of our Retail customers with existing back-up supplies from being eligible for interruption. This will then place some customers in a difficult position regarding their back-up assets which will effectively become stranded and of minimal use.

Even those consumers that have not been interrupted in recent years still have to keep stand-by fuel and have equipment, systems and processes in place to ensure that they can interrupt if called upon to do so. Consequently, we would encourage Ofgem in considering this proposal, to ensure that the costs of stranded assets are factored into their forthcoming Impact Assessment.

Conclusion

E.ON UK considers that the increased complexity of the arrangements will add to customer and User costs and ultimately disincentive Users to participate in the bid process. This could lead to a shortage of interruptible capacity available to DNs and as a result lead to an increased risk to security of supply in the UK and endanger the safety of the system via more rapid progression to all stages of gas emergency. E.ON UK does not consider this to be a satisfactory position to be in and therefore we are unable to lend our support to Modification Proposal 0090.

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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Trading Arrangements
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