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Dear Martin,

**RE: 'Baseline Re-Consultation' & 'The Treatment of Spare / Sterilised Capacity' – E.ON UK Initial Thoughts**

### ***Baseline Calculation***

The process of allocating an individual ASEP with a baseline figure, whether it is within a zone or not, is clearly a difficult task; quite simply because it involves allocating a scarce resource, which inevitably results in 'winners' and 'losers' depending on where shippers hold capacity. With each new determination of baselines, comes another round of 'winners' and 'losers'. One way to potentially minimise the effects on individual ASEPs would be to consider introducing zonal baselines. This is not something we would necessarily advocate as the impact on the NBP are unclear, but the concept may warrant further exploration by the industry to gauge interest.

### ***10% held back rule***

We would strongly advocate a move back to the 20% of capacity held back rule. This would allow much more flexibility for capacity holdings to be optimised closer to when the capacity is actually needed. Forcing shippers to commit to buying large amounts of long-term capacity which ultimately may not necessarily be needed is not always the most efficient option and although trades and transfers aims to mitigate this inefficiency, the process simply requires shippers to go through the administrative burden and expense of regularly offering it back up for sale for trade and transfer in short term auctions. We believe, as a result, that the market could be much optimised better by a move back to the '20%' rule.

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### ***Capacity Substitution***

We do not feel it is necessarily appropriate to have the same NPV test as for the QSEC auctions. Our initial thoughts are that no NPV test or a different NPV test should apply, although we would like to see more evidence on the impact this could have in terms of capacity actually being moved through substitution.

Therefore, at the moment we are tentatively leaning towards the NG suggested Options 1 or 2 for substitution. However, unlike trades and transfers, the industry has not yet seen any significant data to help them work through the options, so it would be extremely useful if NG could come to future Transmission Workstreams with concrete worked examples, as per trades and transfers.

### ***Trades and Transfers***

Given Ofgem's previously expressed views on the subject, it is clear that a one-off event is unlikely to be an acceptable solution for the 'enduring' arrangements. We believe that the future proposals should be based largely around the principles advocated in E.ON UK's previous Modification Proposals 150A & 151A – i.e. integration into existing auctions. This could be achieved through a change to the capacity allocation rules by NG, as opposed to introducing yet more auction rounds.

It could be argued that in order to optimise use of the NTS, the trade and transfer process needs to be much more dynamic than currently proposed. As such, we believe NG should go further and include DSEC auctions in the scope of the 'enduring' arrangements. As the process for DSEC would be largely based on the same functionality for AMSEC / RMSEC, it would seem wasteful not to use the opportunity to include DSEC auctions. This does not necessarily mean that DSEC trade and transfer should be implemented at the same time, but its introduction could be implemented at a later scheduled date after a "test and learn" period when the process would apply to RMSEC and AMSEC auctions only.

In addition, we still feel that there is a valued market for ad-hoc shipper-to-shipper trading of sold capacity between ASEPs – i.e. an extension of the current bilateral entry capacity trading arrangements. As with current bilateral trades, we believe this should be an option open to shippers at any time, and should not necessarily be limited, to or involve, auctions. We envisage that NG's role would be limited to providing an exchange rate and adjusting capacity holdings accordingly. It would be for shippers to negotiate and agree between themselves the price they wish to pay for the

capacity.

### **Spare Capacity**

We agree with the assertion in the NG presentation that a precise definition of “spare” and “sterilised” capacity is required to move this issue forward, although this does not mean that we would necessarily support any measures to deal with it. Currently, our firm view remains that “spare capacity” is fundamentally incompatible with the Transportation Model and any attempt to include it as an afterthought is inappropriate. As stated in our response to Ofgem’s impact assessment on the Transportation model:

*“...the ‘Transportation’ model does not seek to look exactly at how a new entry or exit point will be accommodated, but looks instead at the notional increase or decrease in usage of the system. Therefore, if an increase in capacity in reality requires a “chunk” of investment larger than a potential new entry or exit point, then this is ignored by the model. The model assumes only a “fair share” allocation to meet the calculated change in flows. These chunks of investment create spare capacity for subsequent users. In a similar way to the model ignoring whether actual chunks of capacity are needed to meet an increase in flows, the model also ignores whether spare capacity has been created, perhaps by a previous chunk which can meet a further increase in flows. We believe this is correct, as the model seeks only to measure and cost notional increases or decreases in flows. Accounting for spare capacity, is therefore, inconsistent with the Transportation model principles of modelling increases or decreases in flows.”*

We believe the results of the NTS GCM 06 consultation sent a very strong message from the industry that inclusion of spare capacity into the charging model is simply not needed or desired.

I hope you find these comments useful, but if you wish to discuss them in any more detail, please do not hesitate to contact me.

Yours sincerely

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