eni proposed UNC Mod 501C

November 5th 2014

eni.com

Splitting the Bacton ASEP is a unique challenge

CAM implementation means Bacton ASEP must undergo a unique and fundamental change **but** Mod 501 is not an adequate solution

- Major issues raised by Mod 501 that remain unaddressed
  - Current flexibility / fungibility to utilise LT entry capacity bookings to flow both UKCS and Interconnector gas at any time is being removed.
  - There has been no long term signal or market price for entry capacity to be 'reserved' for an I/C asset specific IP ASEP.
  - Interconnectors are being competitively advantaged versus all other Bacton supply assets.
  - These fundamental changes combine to significantly erode the value of current LT entry capacity bookings and provide cost cross-subsidisation to other users.

Bacton ASEP split context – 1/2

Fungibility was an important consideration in eni's (and we presume other shippers') decision to buy LT Bacton ASEP entry capacity

- a fundamental component of LT Bacton ASEP entry capacity that provides valuable optionality to capture market and project opportunities and mitigate risks through time and an uncertain future. Shippers enjoy the ability to switch interchangeably between UKCS and I/C sourced gas on a day-to-day, hour-to-hour basis for the long term.

Ofgem suggested CAM implementation:

- Split Bacton ASEP to UKCS ASEP and IP ASEP to limit application of CAM to IP ASEP.
- Proposed that existing capacity holders should make a ONE-OFF ELECTION as to how to allocate their capacity to the new UKCS or IP ASEPS.
- Minded-to position that capacity should NOT BE FUNGIBLE between two new ASEPS after the split.
- Set the obligated capacity level at the IP ASEP as the sum of the max. technical capacities of IUK and BBL

These actions erode Original ASEP LT capacity value through both:

- **the loss of fungibility and**
- **the creation of a competing ASEP where the structure, cost and hence value of a long term booking is fundamentally different:** I/C assets have secured long term capacity availability at zero cost with no threat of it being competed away. Interconnector users are then free to bid for cheaper short term entry capacity products as they require in the future, safe in the knowledge that technical capacity always equals obligated capacity at the IP ASEP.

If historic costs are maintained for LT bookings then NG are overpaid and shippers are both overcharged since they receive a less flexible service and are competitively disadvantaged vis-à-vis Interconnector users in the future. This is unfair and discriminatory between network users.

Bacton ASEP split context – 2/2

Eni's proposed Mod 501 C aims to:

1. Establish an actual 'level playing field' by giving all market participants equal rights to re-determine the appropriate price for IP ASEP entry capacity on the new terms following CAM implementation.
2. Maintain fungibility between the two new ASEPs before and after 2018.
3. Enable Bacton split whilst minimizing negative impacts on the value of already contracted LT capacity rights.

Solutions proposed by eni in Mod 501C are:

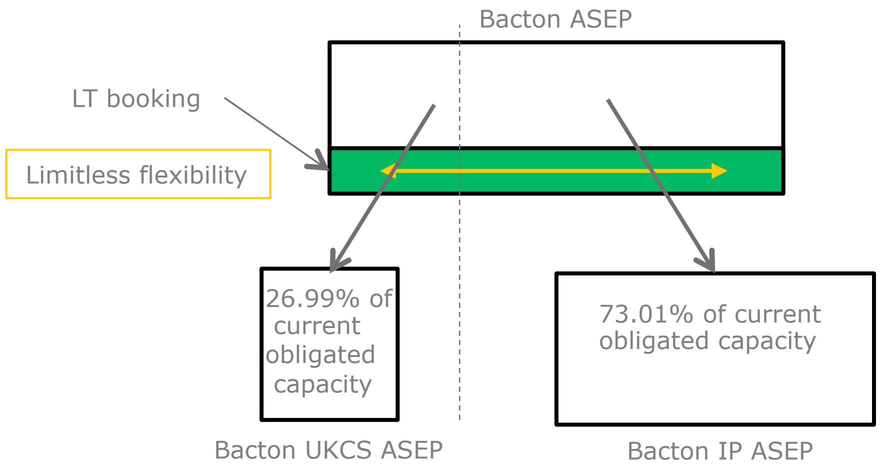
1. Give shippers a right to return capacity and receive a full refund for their existing capacity products that are now competitively disadvantaged by the new IP ASEP entry capacity regime.
2. Introduce an option to over-run capacity up to aggregate individual shipper's capacity bookings at Bacton (UKCS ASEP + IP ASEP) : if ∑nominations ≤ aggregate capacity bookings = no capacity breach.
3. In a bundled I/C world in 2018 and beyond provide a rebate if an existing LT entry capacity holder's bundled capacity bookings result in their double-booking of NTS entry capacity.

Mod 501

Mod 501 raised by NG to deliver Ofgem's proposal on Bacton split.

- **Concerns (among others):**
  - By **removing** fungibility this mod reduces the value of the existing capacity products; by changing the nature of existing capacity product, NG is being overpaid for the now non-fungible capacity.
  - Fundamental change in existing capacity products cannot be consistent with a co-ordinated, efficient and economic operation of the combined pipe-line system.
  - Shippers who have their capacity allocated at unwanted terminals in case of oversubscription and who cannot now use their capacity in a flexible way will have to send an incremental investment signal to regain the LT capacity lost at their desired ASEP. Lower utilisation of already booked capacity now at the unwanted ASEP. This allows NG to release more discretionary and interruptible capacity.
  - In combination, this represents a cross subsidy by existing LT capacity holders to the rest of the shipper community.
  - Introduction of a new asset specific allocation of obligated capacity for the interconnectors delivers an unfair competitive advantage to I/C users over LT term entry capacity holders.
  - Reduced value of existing capacity product can lead to incorrect or no incremental capacity signals and have a negative effect on LT planning and efficient running of the pipe-line system and on security and diversity of supply.
  - The unfair and inefficient pricing of capacity would distort the capacity market between shippers.
  - Poor treatment of existing capacity holders may deter shippers from entering into long term capacity commitments (in case the regulatory goalposts are moved on them). This has negative implications for price signals to National Grid should it need to develop new entry capacity and for security of supply.

Bacton ASEP is undergoing unique and fundamental change – a more equitable approach for existing LT entry capacity holders



Bacton ASEP – obligated baseline 1783.4 GWh/day

IP ASEP - I/C technical capacities 1302 GWh/day
UKCS ASEP – remaining balance 481.4 GWh/day

Current ASEP is being split in a one-off process

1. New UKCS ASEP with characteristics equal to current Bacton ASEP, except capacity no longer fungible to IP ASEP

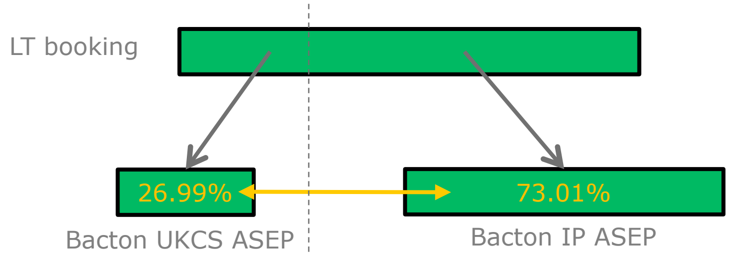
2. A new I/C asset specific IP ASEP. There has been no long-term price signal for this specific allocation of obligated entry capacity to an asset. All the value will be recovered through future auctions, both long and short term, for this capacity.

   This is effectively a 'new' Long Term I/C Entry Capacity product which has been priced at zero on initial allocation to the I/C assets with actual entry capacity prices determined by I/C asset users in the future. (A zero cost 'reservation' of obligated capacity for interconnectors which matches their technical capacities)

Bacton ASEP is undergoing unique and fundamental change – a more equitable approach for existing LT entry capacity holders

Current Bacton ASEP LT entry capacity ownership confers a proportion of the current obligated capacity

- Under any split that historic capacity must first be treated equally to the NG Bacton ASEP split – any other treatment would result both in a cross subsidy amongst existing LT capacity holders and from existing LT capacity holders to future holders.
- Secondly, the split mechanism then needs to take account of the 'new world' and treat LT capacity holders equitably.
- Thirdly, the resultant capacity that remains with LT holders after split should retain the flexibility/fungibility inherent in the existing LT capacity product.



LT holders receive new UKCS ASEP capacity with fungibility mechanism to move to IP ASEP

LT holders face a fundamentally different world. Must be given a choice to move to either
1) new IP Entry Capacity product terms (zero initial 'asset' price + future price defined in future capacity auctions) AND released from current LT booking
Or 2) new I/C ASEP capacity with fungibility mechanism to move to new UKCS ASEP

Mod 501C - seeks to responds to key issues raised by Mod 501

- Entry Capacity Product change at IP ASEP
  - Capacity hand-back option, capped at 73.01%.
    - related to the Obligated Capacity split ratio between two new ASEPs – would move in correlation with any change in Obligated Capacity split.
- Flexibility elements
  - An aggregated overrun regime for existing LT capacity holders allows their capacity to be used flexibly between the two new ASEPs.
  - Post 2018, when only bundled capacity products will be available on the IP ASEP, a rebate granted to existing LT UKCS capacity holders who having bought a bundled product use their LT capacity on the IP ASEP. Rebate equal to the entry NTS price embedded in the bundled product price.

Mod 501C

Mod 501C: eni UK raised this mod to provide a more adequate solution to Bacton Split than Mods 501, 501A and 501B

- Give shippers a right to return capacity limited to a maximum of 73.01% of their existing capacity holdings in response the new I/C Entry Capacity regime and so allow equal rights to re-determine the appropriate price for capacity on the new terms following CAM implementation.
- Gives shippers a right to retain capacity on protected terms: if their capacity is allocated to a NON-ELECTED ASEP, shippers have a right to return their capacity.
- Retains fungibility for allocated retained capacity after the one-off election is completed. Provides an option to over-run capacity up to aggregate individual shipper's capacity bookings. If ∑nominations ≤ aggregate capacity bookings = no capacity breach
- Beyond 2018 adds a rebate if user's bundled capacity bookings lead to their double-booking of NTS entry capacity.
- Releases capacity enabling a larger offer of bundled products on the IP ASEP.
- Long-term capacity products correctly priced.
- No negative implications for price signals to National Grid should it need to develop entry capacity, and for security of supply.
- No discrimination against existing capacity holders and no cross-subsidy.

Mod 501C detail - Allocation and oversubscription

- After appropriate initial indications are received then allocation and oversubscription process is the same as Mod 501A
  - If indications less than obligated capacities at both ASEPS then requests allocated in full
  - If an ASEP is oversubscribed then for those relevant periods a second nomination round occurs. If then indications are oversubscribed allocations are prorated down to the obligated capacity. Indications in excess of capacity are then allocated to the other ASEP or returned to NG according to the user's prior notice.

Mod 501C detail – Flexibility; aggregate overrun regime and rebate

- To provide long term flexibility to historic LT entry capacity retained at UKCS and IP ASEPs after the final allocation.
- Historic entry capacity may be 'utilised' at the other ASEP at any time through an aggregate overrun regime at the combined UKCS and IP ASEPS.
- Rebates on I/C bundled products provided in a post-2018 Bundled IP ASEP world -
  - Historic LT holders of UKCS ASEP capacity who purchase a bundled I/C exit + NTS entry product will be entitled to rebate of the entry capacity charge in the bundled product if 'use' of unutilised LT UKCS ASEP entry capacity at the IP ASEP is nominated.
- On the UKCS
  - Historic LT holders of I/C ASEP capacity may overrun on the UKCS ASEP at any time (and not incur overrun charges), to the extent of their historic capacity booking.

Back-up/additional slides