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Dear Julian,

**Re: Modification Proposals 0116V/0116VD/0116A/0116BV/0116CV: “Reform of the NTS Offtake Arrangements”**

E.ON UK does not support the implementation of this Modification Proposal 0116V.

E.ON UK does not support the implementation of this Modification Proposal 0116VD.

E.ON UK supports the implementation of Modification Proposal 0116A.

E.ON UK does not support the implementation of this Modification Proposal 0116BV.

E.ON UK does not support the implementation of this Modification Proposal 0116CV

Amongst these proposals, we would rank our support for them in the following merit order: (most merit first), 0116A, 0116CV, 0116BV, 0116VD and 0116V. This means that of the proposals that E.ON UK does not support Modification Proposal 0116CV is considered to be the least worst and Modification Proposal 0116V is the worst. In summarising our views we would ask that the Joint Office take care in drafting the Modification Report to ensure that any statements of preferences made by respondees cannot be misconstrued to imply support for a proposal where no such support has been given.

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Our comments are as follows:

**Extent to which implementation of the proposed modification would better facilitate the relevant objectives**

*Gas Transporter Licence Standard Special Condition A11.1*

- (a) *the efficient and economic operation of the pipe-line system to which this licence relates;*

Modification Proposal 116A would enable DNO Users to register their NTS Offtake Capacity requirements beyond September 2010, and allow National Grid NTS to continue to consult and forecast other Users' NTS Exit Capacity requirements consistent with and pursuant to the relevant provisions of UNC Section O, which would allow National Grid NTS to undertake better informed investment decisions beyond 2010 and thereby better facilitate the efficient and economic operation of the NTS pipeline system.

The introduction of four year long-term user commitments (Modification Proposals 0116CV, 0116BV, 0116VD and 0116V) does not on the face of it permit any flexibility to allow alignment of the investment schedule of the connected facility build with that of National Grid in reinforcing the NTS this will reduce the efficiency of investment in the pipeline system. The current ARCA arrangements allow such flexibility, without placing unnecessary financial risks on shippers.

We do not believe that it is appropriate to have a commitment to pay four years of NTS Exit Capacity charges. We consider that a one year commitment is appropriate and that adequate investment signals at Exit are already given through Advance Reservation of Capacity Agreements (ARCAs). ARCAs provide sufficiently large financial commitments to guard against stranded assets whilst allowing reinforcement works to be aligned with the new or incremental increase in gas load.

In reality, the flexibility product outlined in Modification Proposals 0116BV, 0116VD and 0116V is of little use to the SO in managing the system and conversations (in private) with experienced system operations staff will confirm this. This lack of utility combined with the fact that the crude design of the product prevents accurate targeting of costs at those parties that supposedly cause those costs (e.g. entry users are excluded), means the resulting flexibility charges cannot be described as cost reflective.

We understand that SO costs are more likely to be affected by how far in advance hourly flow data can be provided to the SO and the accuracy of that data; whether this is DFN information at the beach or OPN data for NTS users at exit. If the SO has adequate time to prepare the system, it is able to efficiently plan to provide the deliverability needs of its users at minimum cost. Failing this, ramp rates and notice period limit the flexibility so as to not to prejudice the safe operation of the system. In short the flexibility product and the associated complex processes could become a major distraction for system control staff who would otherwise be able to concentrate their time on their primary responsibility namely the safe and efficient operation of the system.

- (b) *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

Modification Proposal 0116A would enable National Grid NTS and DNO Users to formally confirm NTS Exit Capacity levels to support their respective investment decisions beyond September 2010 and thereby better facilitate the coordinated, efficient and economic operation of the combined pipe-line system.

The introduction of 4 year long-term user commitments (Modification Proposals 0116CV, 0116BV, 0116VD and 0116V) does not on the face of it permit any flexibility to allow

alignment of the investment schedule of the DN with those of National Grid NTS. This will reduce the efficiency of both National Grid NTS investment schedule and may prevent the flexibility to subsequently amend investment decisions which might otherwise be tied to a particular user commitment. The current ARCA arrangements allow flexibility to amend investment schedules without placing unnecessary financial risks on DNOs.

- (c) *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

Modification Proposal 0116A would restore the enduring nature of the UNC in a manner that does not require significant implementation costs. The substantial cost of new systems required for all other proposals (0116CV, 0116BV, 0116VD and 0116V) could be avoided. We understand National Grid NTS will incur several millions of pounds of costs on systems. Taking into account the extra cost of additional staff to manage the extra complexity a conservative estimate of National Grid's cost that might otherwise have been avoided of around £5m NPV would not be unreasonable.

Ofgem will no doubt argue that customers are protected against these costs as they consider that such costs are part of the DN Sales process. Nevertheless it is a fact that costs will have been incurred and from a UK plc point of view such expenditure represents the destruction of the wealth of the nation as a whole, albeit that it will have to be paid for by National Grid's shareholders.

- (d) *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*

- (i) *between relevant shippers;*
- (ii) *between relevant suppliers; and/or*
- (iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

Modification Proposal 0116A would continue to secure effective competition between relevant Shippers without exposing them to ineffective competition with DNO Users. DNOs as regulated natural monopolies have an absolute obligation to acquire flexibility capacity to fulfill their 1 in 20 license obligation (which is also likely to be an implied obligation of their Safety Case agreed with the HSE) and this may lead them to act as distressed purchasers in some circumstances.

E.ON UK considers that arguments put forward to support radical reform of the NTS Offtake Arrangements (Modification Proposals 0116CV, 0116BV, 0116VD and 0116V ) are flawed. This is particularly relevant to this objective (c) but it also is relevant to objectives (a), (b), (d) and (f).

In the Authority's February 2005 decision document "National Grid Transco – Sale of gas distribution networks," they state

***“Undue discrimination between NTS offtake points.***

*The offtake arrangements should deliver a framework in which the risk of Transco NTS unduly discriminating between DNs and parties who hold agreements with Transco NTS at other NTS exit points is minimised. Ofgem therefore considered that the arrangements should be developed in a way that delivers consistency of treatment between the DNs and holders of Network Exit Agreements (NExAs), Connected System Agreements (including those applicable to interconnectors) and Storage Connection Agreements (SCAs).”*

Later on in the document they add

*“As a result of DN sales, we accept that robust commercial arrangements will need to be established at the previously internalised interface between the NTS and the DNs, i.e. the NTS/DN offtakes. Furthermore, to ensure equality in treatment of all users connected to the NTS, these arrangements should also apply between NTS and directly connected customers. This will serve to ensure that access to the NTS is provided to all network users in a manner that is not unduly discriminatory.”*

This not the view shared by E.ON UK nor we believe most market participants. Indeed as far as we are aware no market participant has formally complained about undue discrimination with respect to the current NTS offtake arrangements. Although we are aware that a challenge against National Grid’s user commitment set out in a proposed ARCA for Marchwood power station of four years rather than the one year commitment established by the earlier Langage determination) was recently upheld by Ofgem and that the determination was in line with the current established NTS offtake arrangements.

E.ON UK has obtained a legal view from counsel which amongst other matters concludes;  
*“Proper application of the non-discrimination provisions (as set out in The Gas Act 1986 and various European directives);*

- *requires answering two questions: (a) are the users or classes of user materially comparable; and (b) is there a valid reason, or objective justification, for any difference in treatment.*
- *may not only permit but actually require that material differences between classes of user be reflected in appropriately different treatment.”*

E.ON UK believes the various classes of NTS User are not materially comparable, that there are valid reasons for their different treatment and as such different treatment is appropriate. Gas DNOs are subject to price control regulation, whilst shippers who ship gas to TCCs, storage facilities or export gas through interconnectors operate in the competitive market. Shippers are not in a position to be able to fairly ‘compete’ with DNs for access rights, nor are they necessarily able to provide long term commitments in the same way as such monopoly network businesses whose income stream it ultimately secured through the price control process. In addition, the ‘connected facilities’ themselves are also subject to a variety of different licensing and exemption regimes reflecting their different circumstances. By continuing to allowing appropriate differences in the NTS offtake arrangements for different classes of Users to persist Modification Proposal 0116A better facilitates the achievement of Standard Special Condition A11, paragraph 1 (a), (b), (c) and (f), whereas Modification Proposals 0116CV, 0116BV, 0116VD and 0116V are detrimental to these conditions.

Competition in shipping and supply is adversely affected by the fact that additional one-off and on-going costs faced by users for implementation of 0116CV, 0116BV, 0116VD and 0116V are relatively fixed which means that larger shippers will be advantaged as they will be able to spread these ‘fixed’ costs more thinly. This applies to shippers that flow gas to TCCs, interconnectors or storage facilities, although it is clearly most marked by those parties that supply gas to TCCs. Gas fired generators will also face additional costs compared to other forms of generation.

For 0116V, 0116BV, 0116VD, (but not 0116CV ) storage facilities and the UK- Continental interconnector will face the added burden of the need to renegotiate contracts with each of its users, together with the management and allocation of the costs of flexibility overruns between entry and exit allocations for all its users. This will reduce the competitiveness of storage and interconnector deliveries compared with other sources of supply (particularly under peak demand conditions). Shippers that happen to rely more on these sources of supply will necessarily be disadvantaged and this will in term distort competition in the shipping or supply of gas.

The counter-seasonal nature of storage operations (i.e. storage users will not be injecting on a peak demand day) mean that storage users may have to pay for expensive firm

capacity (under Modification Proposals 0116CV, 0116BV, 0116VD and 0116V) even though they are not using that capacity. This will in turn mean that storage users could effectively end up 'over-paying' for access to the system and cross-subsidise other users. This will tend to undermine the competitiveness of storage compared to other sources of peak supply in turn this will competitively disadvantage those shippers that tend to use storage.

The proposals are also inconsistent with the existing 'shallow' connection policy which firmly places investment risk on the gas transporter based on an understanding that efficient investment will always form part of their ongoing regulatory asset base. This new 'shallow' connection policy was adopted by Ofgem in the late 1990s, in part to ensure costs for new entrants did not become a barrier to entry. It is also supported by Ofgem's Langage and Marchwood ARCA determinations.

Although a four-year commitment places less risk on National Grid it does not reduce overall market risk; rather, it inefficiently transfers it to the Users who are less well placed to manage such risk. Given the current instability in the UK wholesale gas market, it would seem unwise to further add to user investment risks.

We also do not support the minimum of 14 months notice to reduce holdings of Prevailing NTS Exit (Flat) Capacity. It is our opinion that this can be viewed as a tax on exit from the market. It provides little or no value in terms of market signals and parties may regard this ongoing commitment as a sunk cost which may contribute, at the margin, to a delay in exiting the market. This could sterilise capacity which might otherwise have been released to other users.

The move towards a 4 year user commitment under Modification Proposals 0116CV, 0116BV, 0116VD and 0116V and the longer notice to reduce holdings necessarily make the current NTS connection regime less shallow. It follows therefore that a move in this direction will necessarily create barriers to entry and exit which will have an adverse impact on competition in shipping and supply.

The current arrangements for aligning downstream capacity holdings with exit capacity bookings at exit at interconnectors will have to be changed. For example for the Irish interconnector UK shippers must obtain 'downstream capacity tickets' from the downstream interconnector party or parties before they can book exit capacity from the NTS. As such the change envisaged under Modification Proposal 0116CV, 0116BV, 0116VD and 0116V will create a barrier to trade between member states of the EU and the increased uncertainty in the arrangements for acquiring exit capacity is likely to weaken competition between shippers in the UK wishing to ship gas to Moffat or Bacton.

Targeting costs at users that 'cause' those costs is invariably seen as pro-competitive, as those that are deemed to be acting appropriately and incur less costs will be able to better compete in the marketplace. In our view the flexibility product described under Modification Proposals 0116BV, 0116VD and 0116V do not improve cost targeting and proposal 0116BV only slightly mitigates the arbitrary cost allocation that seems to be a feature of the flexibility product.

The amount of flexibility that National Grid is able to make available to parts of the country are dependent on the patterns of both entry and exit flows. It cannot be ascribed solely to exit. The profile of flows at entry can, theoretically, have a beneficial or detrimental impact on the level of SO cost, in the same way as profiling at exit can. Under the proposed regime, a shipper will face a flexibility charge even though he may have in fact physically varied input flows at a local entry terminal to match the flexibility supposedly 'used' at entry. We believe it is impossible to divorce flexibility at exit from flexibility at entry, thus to charge one without charging the other is not cost reflective<sup>1</sup>.

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<sup>1</sup> E.ON UK believes an entry flexibility charge has as little merit as an exit flexibility charge, neither provides any real utility for the SO in helping to efficiently manage the system.

TCCs find it difficult to understand that despite providing the most reliable information of all NTS Users, they now have to face paying an additional new charge for a service which is currently included in a 'bundled' exit capacity charge. The existing "1/24 hourly flow rate" rule ensures that these users already book and pay a fair price for flexibility. This approach to charging is elegantly simple and allocates costs more consistently than the application of separate flat and flexibility charges.

Realistically, the only way in which more accurate cost targeting of changes to within-day flows can be achieved is through the adoption of shorter gas balancing periods, but it is widely understood that introduction of such a radical change would be prohibitively expensive. By expecting users to manage flows across two discrete periods of the day the flexibility product is nevertheless a stepping stone towards shorter-gas balancing periods. Unfortunately, the resulting exit flexibility charges fail to target costs appropriately, whereas dividing the day into two balancing periods might do so.

Another adverse impact on competition for Modification Proposals 0116CV, 0116BV, 0116VD and 0116V is the increased cost of providing financial security for longer-term user commitments. Clearly this will end to impact smaller players to a greater degree than more financially secure larger companies.

- (e) *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers; and*

No comments

- (f) *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Modification Proposal 0116A requires minimal changes to the UNC, existing processes and existing systems. In contrast all other Modification Proposals 0116CV, 0116BV, 0116VD and 0116V (although 0116CV to a much reduced extent) increase the complexity of the code arrangements. Unfortunately more complexity means there is more to go wrong and a much greater chance of adverse unintended consequences. The cost of the modification process will inevitably increase as a rash of corrective modification proposals are submitted should radical changes to the offtake arrangements be implemented.

### **The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation**

Implementation of Modification Proposal 0116CV, 0116BV, 0116VD and 0116V (although 0116CV to a reduced extent) will undermine security of supply in both the gas and electricity markets. The added complexity and User Commitments from the 'flat capacity' product will at the margin delay or postpone investment in generation and storage capacity as these investors face much greater risks. Electricity capacity margins and the availability of flexible gas supplies could be reduced as a result.

The flexibility product loads costs on storage operators and tends to most disadvantage storage compared to other sources of peak flexibility. Security of supply is arguably best enhanced through local sources of supply within UK jurisdiction (e.g. UK storage) than from non indigenous and often remote sources of supply.

The introduction of Modification Proposals 0116CV, 0116BV, 0116VD and 0116V will further weaken and fragment governance of market rules as yet more terms and conditions for access are 'hived-off' into non-code documents e.g. the ExCR methodology statement. Over time this will weaken users influence over market rules and will certainly limit their ability to propose changes to

such market rules. Proper scrutiny of changes with increased fragmentation will be more difficult which will over time weaken the integrity of the market arrangements.

It is important that the Governance of changes to systems and process should be consistent with Ofgem's Gas DN Sales 'Option C' approach in which xoserve took the lead role in oversight and Governance of UK Link Systems. It is important that this approach is not compromised and the industry continues to be protected from further fragmentation of these arrangements.

### **The implications for Transporters and each Transporter of implementing the Modification Proposal, including**

- a) implications for operation of the System:**
- b) development and capital cost and operating cost implications:**
- c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:**
- d) analysis of the consequences (if any) this proposal would have on price regulation:**

Each of the Modification Proposals 0116BV, 0116VD and 0116V will adversely impact each of the above factors. As described earlier the flexibility product is so crudely designed and is likely to be so ineffective in targeting costs that, at best it will be a unwelcome distraction in seeking to efficiently operate the system, and at worst could cause perverse behaviours as parties seek to flow gas to optimise flexibility when such optimisation is not required or is actually detrimental to system operation. Operational costs for managing the system are likely to increase as a result of these proposals.

Capital costs could be higher than they need be as National Grid NTS seek to invest based on user commitments in preference to relying on traditional planning processes. National Grid NTS will naturally be willing to invest if it considers a healthy return is backed by a user commitment even-though they know that the new committed incremental load has either been delayed or postponed. It is inefficient to continue to invest in accordance with the user commitment 'signal' in such circumstances.

National Grid seems content to put forward proposals that will create substantial cost burdens on users that operate in the competitive market. Unfortunately these costs are rarely taken into account and are often conveniently ignored. Given that these proposals have only been put forward as a condition of National Grid's sale of gas distribution networks it would seem more fair and equitable if these external costs were translated into a further reduction of National Grid NTS's allowed revenue for implementation of these reforms.

### **The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

Through introduction asymmetrical and unduly onerous user commitments Modification Proposals 0116CV, 0116BV, 0116VD and 0116V transfers risk away from National Grid NTS to shippers and DNOs although we would argue that National Grid NTS are best placed to manage those risks. We are not aware of any sudden increase in "stranded asset" scenarios or concerns from customers in regard of the current regime and therefore, we do not see any reason for change.

Modification Proposals 0116CV, 0116BV, 0116VD and 0116V place unreasonable contractual risk on DNOs, with respect to their acquisition of flexibility capacity. DNOs will ultimately be required to outbid users that operate in the competitive market if they need to acquire flexibility capacity to meet their 1 in 20 obligation.

## **The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

We understand that major changes to systems are required. National Grid NTS appear to be developing these systems in anticipation of approval of their Modification Proposal 116V – clearly they do this at their own risk.

It is important that the Governance of changes to systems and process should be consistent with Ofgem's Gas DN Sales 'Option C' approach in which xoserve took the lead role in oversight and Governance of UK Link Systems. It is important that this approach is not compromised and the industry continues to be protected from further fragmentation these arrangements.

## **The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**

National Grid NTS's Mod 116V is very similar to the proposal put forward by Ofgem's during the gas distribution network sales process. At that time the Gas Forum commissioned a report to "Review of the Proposed Gas Exit Arrangements" dated 28 June 2005, which concluded that the net present value (NPV) industry cost impact of the reforms could be as much as -£100m. NERA economic consultants are currently working on an updated report for the Gas Forum and should be in a position to report latest industry cost estimates shortly.

In Appendices A and B we have attached is E.ON UK's cost submission to NERA as a shipper and a prospective storage operator. This information is commercially confidential and should not be included unless appropriately 'anononised' in the Final Modification Report. However we are happy for the Joint Office to share this information with Ofgem.

At the time of the original Gas Forum cost-benefit study the details of the enduring offtake arrangements were sketchy to say the least. Having now seen the full proposals these arrangements have turned out to be even more complex than we had expected (especially the flexibility product). We have therefore increased our IT cost and risk valuations substantially. To summarise the relative costs to our business range from a slightly positive NPV (i.e. a benefit) arising from the removal of the uncertainty associated with lack of market rules beyond 2010 for Modification 0116A, to a significant negative NPV for Modification Proposals 0116V and 0116VD. Modification Proposal 0116BV was considered to be marginally less bad than 0116V and Modification 0116CV's cost was around a third of 0116V cost reflecting the fact that most of the cost is driven by the flexibility product.

The unbundling of exit charges into flat and flexibility element (Modification Proposals 0116BV, 0116VD and 0116V) will inevitably create huge uncertainty in the levels of exit TO and SO charges from year-to-year. This unpredictability will add to shippers' risks which will ultimately be reflected in increased charges to customers.

Under Modification Proposals 0116CV, 0116BV, 0116VD and 0116V shippers will have to provide increased security cover (one years cover) rather than measuring indebtedness based on the monthly amounts owing that currently applies. It is unlikely that this will involve a significant cost to larger companies such as E.ON UK or its parent E.ON AG, but may require smaller players to lodge cash or present letters of credit which would have to be financed.

## **The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party**

In our view, longer user commitments might delay investment in much needed gas-fired generation; the only form of generation that can realistically fill the electricity supply gap in the medium-term. The added risk of being financially 'on the hook' for such commitments means millions of pounds could be wasted by a delay to a project whereas the current 'negotiated' Advance Reservation of Capacity agreements at least offer the prospect of rescheduling reinforcement works to coincide with a delayed build schedule.



The specific risks we have identified include that perceived increased risk of not being able to obtain back-up supplies from the NTS for two of our power stations which rely primarily on other sources of supply but may have to obtain alternative NTS supplies at short notice. The flexibility arrangements set out in Modification Proposals 0116V, and 0116VD and to a lesser extent 0116BV introduce both introduce an administrative delay in the allocation of flexibility and at the same time through the national and zonal limits artificially constrain the availability of flexibility capacity creating a false scarcity. These processes do not work with the need to offtake additional gas at short notice and they certainly do not allow generators (under threat of flexibility overrun penalties) to obtain such capacity in time to back-off the overrun risk ahead a National Grid bid-offer acceptance in the electricity balancing mechanism.

### **Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal**

As stated earlier there are implications with respect to non discrimination. It is our view that implementation of any of Modification Proposals 0116CV, 0116BV, 0116VD or 0116V would not be appropriate. We consider there is a valid and objective justification, for any difference in treatment between TCCs, DNs, Storage Facilities and Interconnectors and that a proper interpretation of legislation, licences and regulatory obligations would conclude that material differences between classes of user should be reflected in appropriately different treatment.”

We are also aware that great concerns have been expressed by Irish stakeholders given that the island of Ireland is almost entirely dependant on gas offtaken from the NTS at Moffat, and for the Isle of Mann this is their own source of gas supply. As a consequence, the arrangements for the allocation and management of gas flows at Moffat will have to change if any of the Modification Proposals 0116CV, 0116BV, 0116VD or 0116V were to be implemented.

These arrangements may thus represent an impediment to trade between member states and may be contrary to Treaties governing the allocation of capacity rights in the Irish Interconnector agreed between the British and Irish Governments

### **Analysis of any advantages or disadvantages of implementation of Modification Proposal 0116 A**

#### **We have identified the following advantages:**

- (a) The uncertainty about post 2010 access rules is removed.
- (b) Negligible implementation cost for shippers, DNOs, storage operators and interconnector operators.
- (c) Expenditure of new IT systems by National Grid NTS can be avoided.
- (d) Different treatment of users that are demonstrably different is legally more likely to be considered as non-discriminatory
- (e) Additional credit security for smaller players entering the market would not
- (f) Reduced regulatory overhead necessary to oversee new complex arrangements.
- (g) The integrity of the shallow connection policy is maintained as unduly onerous user commitments are not required.
- (h) Generators and other TCCs can operate with confidence knowing that flexibility capacity will be made available when needed and that they won't be outbid by the local monopoly DNO if things get tight.
- (i) The creation of barriers to trade in gas between member states of the EU can be avoided as there is no need to change the arrangements for the alignment of exit capacity with downstream capacity holdings.
- (k) No changes are required to the Gas Emergency Procedures

#### **We have identified the following disadvantages:**

None

## **Analysis of any advantages or disadvantages of implementation of Modification Proposals 0116CV, 0116BV, 0116VD and 0116V**

### **We have identified the following advantages:**

- (a) The uncertainty about post 2010 access rules is removed .
- (b) Most of the shipper, DNOs, storage operators and interconnector operators costs are avoided if the flexibility product is abandoned under 0116CV

### **We have identified the following disadvantages:**

- (a) Significant implementation costs for shipper, DNOs, storage operators and inter connector operators are incurred.
- (b) Significant expenditure systems by National Grid NTS
- (c) Reliance on user commitments rather than planning and alignment of reinforcement with the build schedule for any new load will result in inefficient investment.
- (d) Arrangements are likely to not treat various classes of users differently when the law may demand that it does.
- (e) Additional credit security for smaller players entering the market may harm competition.
- (f) Longer user commitments may delay or postpone investment in much needed gas fired generation capacity. Commitments may create barriers to entry or exit which may undermine competition in shipping and supply.
- (g) Other than 0116CV the management of flexibility capacity and particularly the allocation of overruns between entry and exit allocations mean that storage is at a competitive disadvantage to some other sources of supply. This may in turn weaken security of supply supplies particularly at the peak are source from sources outside UK jurisdiction.
- (h) Other than for 0116CV generators and other TCCs will sometimes have to operate in an environment where obtaining flexibility capacity is uncertain especially when shippers supplying TCCs are likely to be outbid by the local monopoly DNO if things get tight.
- (i) Generators may operate their plant less flexibly to avoid the risk of overruns. This may reduce gas security of supply as there may be reduced scope for demand side response.
- (j) The flexibility product does not accurately target costs at users that use flexibility particularly as it takes no account of the inter action between entry and exit flows.
- (k) The flexibility product is such a crudely designed it has little if any utility for the efficient management of the system – it is more likely to increase the overall cost of managing the NTS.
- (l) Increased regulatory overhead necessary to oversee new complex arrangements.
- (m) Barriers to trade in gas between member states of the EU may be created.
- (n) The removal of Interruptible capacity may have implications for the safety of the system under the Emergency Procedures as the option for the Network Emergency Co-ordinator to curtail interruptible demand first will have been removed.

### **The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation**

In our view the effective removal of the current interruptible arrangement under Modification Proposals 0116CV, 0116BV, 0116VD or 0116V could make the safe management of a gas emergency by the Network Emergency Coordinator (NEC) more difficult. Currently interruptible customers can be interrupted for energy balancing reasons in Stage 1 of the Emergency Procedures but this option will not exist and all demand will instead be managed through firm load shedding at Stage 3 of the Emergency Procedures.

This would appear to increase the severity of an emergency and its potential duration as the NEC is forced to go to Stage 3 much earlier than might have otherwise been the case. This may be perceived to undermine safety and it certainly reduces continuity of supplies to some firm customers who might otherwise have been curtailed after the previous interruptible load.

We are not aware to what extent discussions on this matter have taken place between National Grid

and the Health and Safety Executive with respect to this issue. In the past we have found that National Grid have imposed unilateral changes to emergency arrangements (with profound commercial implications on Users) without proper consultation – we therefore need to be kept informed about the nature of discussions between National Grid, Ofgem and the HSE on this matter.

**The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

No comment

**Programme for works required as a consequence of implementing the Modification Proposal**

No comment

**Proposed implementation timetable (including timetable for any necessary information systems changes)**

The implementation timetable does not allow market participants to adequately prepare systems and processes to manage the new arrangements. Most of these arrangements will have to be developed post implementation.

This is not a satisfactory state of affairs and would never be entertained in the electricity industry where preparations for implementation do not take place in advance (i.e. preparations do not pre-judge a modification decision). Take for example the introduction of zonal transmission losses under the Balancing and Settlement Code under the BSC, which despite users having systems largely ready following the last aborted proposal the implementation date is now put back to October 2008 and we have to wait until March 2007 for Ofgem to make a decision. This is for a change that is much less profound (and in contrast to the enduring offtake arrangements is actually supported by a significant proportion of the industry). Why the need to rush Modification 0116 through the process?

**Implications of implementing this Modification Proposal upon existing Code Standards of Service**

No comments

**Further Comments**

In coming to its decision we would urge Ofgem to reconsider its support for radical reform to the NTS offtake arrangements. Widespread opposition to these proposals from a diverse range of stakeholders, whether these are customers, shippers, storage operators, interconnector operators, Irish shippers, the Irish regulator (CER) and (in private) transporters should mean something.

These proposals would never have been brought forward by National Grid if it was not for Ofgem driving this agenda. The use of conditional licence conditions (approved by the Authority) to drive change must surely undermine the ultimate legitimacy of any Authority decision to approve all but one of these proposals. Ofgem have in fact been involved in all aspects of National Grid NTS's proposal.

The UNC Modification Procedures were designed for Users to independently bring forward proposals to code rules to address genuine industry concerns with the arrangements. The use of Ofgem chaired meetings to drive forward change outside formal industry processes has unfortunately resulted in transporters using the Modification Procedures to 'rubber stamp' pre-agreed' positions with the regulator.

In the light of strength of industry opinion, concerns about due process, views expressed on undue discrimination, the adverse impact on competition and the sheer magnitude of the cost burden these proposals will place on users we trust Ofgem will conclude that Modification 0116A, i.e. making the current arrangements enduring represents the only credible way forward.

Yours sincerely

Peter Bolitho  
Trading Arrangements Manager  
E.ON UK

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Appendix A - NERA Questionnaire on NTS Offtake Reform – E.ON UK response as a shipper.

Appendix B - NERA Questionnaire on NTS Offtake Reform – E.ON UK response as a prospective storage operator.

*(Please note these attachments should be considered as Commercially Confidential and should not be published on the Joint Office of website. However, we would ask that these documents be included as part of E.ON UK's response that is forwarded the Authority as part of the Final Modification Report)*