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Dear John,

**RE: National Grid Gas (NTS) SO Incentives for 1 April 2009 - Initial Proposals Consultation**

E.ON UK welcomes National Grid Gas (NGG) sharing its thoughts on the initial proposals for its SO incentive arrangements. As we have outlined in earlier responses, whilst we welcome the opportunity to get involved in development of the incentives, we have an on-going concern about the suitability of the monopolist, NGG, setting its own incentives and an apparent lack of Ofgem involvement in the development process. We firmly believe Ofgem should be focusing its attention on monopoly regulation, since this is where it has the relevant expertise and knowledge, rather than obliging Shippers who do not have access to the same level of information, to “police” NGG. A Shipper’s role in this process should be to provide our operational insight and feedback to inform development of incentives – not to be reviewing and setting detailed incentive structures.

**Residual Balancing**

Scheme B seems close to the approach that the Gas Forum/TPA recommended in its response to the “Initial Thoughts” consultation. We believe this scheme retains an appropriate cost targeting framework and reduces the likelihood of unnecessary balancing actions being taken by NGG, when linepack is close to target levels. However, we note that the absence of an absolute target means that Shippers will continue to be funding operational changes in linepack through the balancing mechanism.

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As is consistent with our position on all SO incentives, we believe the arrangements should be subject to annual review in order to remain cost-reflective and transparent to Shippers.

### **Inter-Day Transfer Service**

We are pleased to see that NGG has recognised significant industry concerns raised in the initial thoughts consultation and has stepped back from further development. We believe that this product will require careful consideration to ensure NGG is not seen to be “in the market” and thereby influencing prices.

### **Shrinkage Procurement**

Based on the recent announcement by NGG to reduce the NTS SO Commodity charge by 53% in February 2009 as a result of a reduction in shrinkage cost of around £30 million, we believe there is merit in exploring why such volatility came about this year and whether the incentives (e.g. the quarterly, rather than annual, structure) were a contributing factor to this very significant adjustment.

### **Unaccounted for Gas (UAG)**

We support the introduction of a specific UAG scheme, and think that gross UAG is an appropriate measure. However, we are uncomfortable with the proposed concept of effectively giving NGG money without any obvious indications of how or where this will be spent. For instance, NGG highlights that it only owns 32 of the 204 exit meters and none of the entry meters. We fail to see the benefit in paying NGG to effectively make sure another party – the meter operator – is carrying out its job properly. In any case, this role is for BERR, rather than NGG.

NGG’s apparent lack of direct control over the causes of UAG leads us to believe that now is perhaps not the right time for a specific UAG scheme. We believe that NG needs to do more footwork to establish the specific drivers of UAG (without specific funding). However, if this proposed UAG scheme is implemented, then we believe that the incentive should be shorter rather than longer and reviewed on a regular basis to ensure it is delivering the anticipated benefit of reducing UAG volumes.

### **Operating Margins**

We were surprised by NGG’s intention to run a procurement exercise in January 2009, which would be expected to include new, non-storage providers. Although NGG has engaged with possible alternative providers (such as CCGT owners/operators), this has been at a high-level and we have only recently seen drafts of the fine detail of the proposals. In terms of incentives, we are sceptical about whether the contestability project in 2009 will deliver an



outcome upon which future incentive arrangements for Operating Margins procurement can be based. Many potential providers may not be sufficiently well prepared for the tender and therefore take-up may not be as high as expected.

In terms of NGG's proposal for cost pass-through, we believe that since NGG is controlling the tender process and making decisions on the responses, this has the potential to prove costly for Shippers and therefore we believe it would require very careful monitoring by Ofgem to ensure that Shippers are not exposed to excessive costs. Overall, in the absence of any reliable information on how successful contestability will be in bringing prices down, we believe the objective for the forthcoming year at least should be to keep the primary incentive related to minimising the cost of the service.

#### **Data Publication Incentive**

We do not support this incentive being rolled forward. As set out previously we believe the appropriate industry benefits have now been delivered, the incentive should be abandoned and that this could now be managed through a 'standards of service' scheme.

I hope that the above comments prove useful. Should you wish to discuss our response further, please do not hesitate to contact me on the number above.

Yours sincerely

**Richard Fairholme (by email)**

Trading Arrangements  
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