



Ian Pashley
National Grid Gas
National Grid House
Gallows Hill
Warwick
CV34 6DA

E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
West Midlands
CV4 8LG
eon-uk.com

Richard Fairholme
T 02476 181421
richard.fairholme@eon-uk.com

Friday, 26 September 2008

Dear Ian,

RE: Conclusions on Operating Margins Contestability and Initial Thoughts for Associated SO Incentive Arrangements

E.ON UK welcomes National Grid Gas (NGG) sharing its thoughts on its possible incentive arrangements and plans for development of OM contestability. Overall, we remain unconvinced by the economic feasibility of extending procurement of OM services much beyond the current pool of providers. It is unfortunate that NGG is effectively forced to implement changes to OM provision due to Licence conditions, particularly before there has been any clear benefits set out to support change from the *status quo*.

As we stated in a previous response on OM contestability, given the relatively small commercial value of OM gas, the stringent supply requirements and unpredictable use by NGG, we remain sceptical about how attractive the process will be for potential alternative providers. It seems almost inevitable that given the uncertainty of OM utilisation, any prudent potential provider would factor-in a risk premium to their "offer" to NGG and hence the cost for NGG of entering into alternative contracts for supply may actually increase compared to the current arrangements. As such, we remain unclear where the actual cost savings can be made, although we would welcome NGG's view on this matter.

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

As highlighted by the recent DN Interruption tender process, there are many difficulties associated with matching up very specific Transporter requirements with offers for a service by Users. Whilst the range of OM procurement options on offer to NGG may expand, ultimately, NGG as system operator is the only one who can (quite rightly) decide whether to accept or refuse tenders and therefore there can be no guarantee of increased competition or cost savings. In addition, we do not believe it would be prudent for NGG to be obliged to take any minimum quotas from certain supply sources (e.g. x % from CCGTs, x % from storage, etc.) unless NGG can clearly demonstrate the system safety and cost efficiency benefits of doing so.

Our concern with opening up OM contestability is whether it really will deliver any tangible benefits for market participants. As NGG correctly recognises in this consultation document, there are very significant contractual and safety implications of widening the current pool of providers. We risk going through a highly complicated and resource intensive tender process (for both Transporter and provider) only for NGG to decide that, for instance, the current pool of providers is still the best option. If the benefits are only marginal and the value of OM procurement is relatively low, we question whether it is really worth adding so much extra complexity to the current arrangements. We remain sceptical whether increased competition necessarily equals lower cost. If development of OM contestability is to progress, it is clear that a transparent and detailed assessment of the costs and benefits of change from the *status quo* will be required; which could be achieved via an early Ofgem Impact Assessment. We would also expect to see close involvement of the HSE/NEC in ensuring any Modification Proposals put forward fully satisfy Safety Case requirements.

At this stage it is impossible for us to carry out a commercial assessment of the various options proposed by NGG until there is a more detail on what the product is and how the mechanisms will work; particularly in regard of OM provision from NTS-connected demand.

In respect of incentives, we consider that designing suitable arrangements for a monopoly is not the role of Shippers – this is clearly for Ofgem to consider, implement and monitor. However, broadly speaking the primary focus should be on NGG *reducing* the cost of OM procurement, rather than necessarily acting innovatively to procure its requirements. For instance, focus of an incentive could be placed on how robust and effective NGG's current forecasts of OM volume are; e.g. re-examine the fundamentals behind the volume determination with the aim of minimising the total requirement.

We also do not believe that it would be appropriate at this stage to move away from the position where all risk and reward resides with NGG, until competition has actually been established.



I hope you find these comments useful. If 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
E.ON UK