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Tuesday, August 21st, 2007

Dear Andrew,

RE: The Entry Capacity Transfer and Trade Methodology Statement – Second Consultation

E.ON UK continues to support the implementation of a robust and effective entry capacity trades and transfer process this coming winter. The accompanying and supporting methodology statement is fundamental to enable parties to understand and assess the impact of the current winter-specific Modification Proposals 156, 156A, 169 and 169A. Although we are supportive of most of the high-level principles of transfer and trade set out in Modification Proposals 156, 156A and 169, we have some concerns around the detail of the supporting methodology statement, which we set out in this response. Many of our concerns relate to the lack of transparency associated with the proposed arrangements and we believe that any enduring solution must place transparency and simplicity at the top of the agenda.

Material Increase in Costs

Ultimately the success or failure of the transfer and trade process will depend on NG NTS' assessment of what is deemed a 'material' increase in costs: a term used throughout the statement. The lack of a precise definition of "material increase" in the context of the trade and transfer process restricts the extent to which the methodology can be assessed objectively and replicated by Users. We are also concerned that in the absence of a precise definition, an overly conservative approach could be adopted by NG NTS, resulting in either very few trades and transfers taking place or small amounts of capacity being moved this winter.

Whilst we appreciate that the term 'material increase' has long been a

contentious area of the draft Transporter licence, we believe that on-going uncertainty around what it *actually* means both for NG NTS and Users could be resolved by a Licence definition or quantification.

It is also confusing to see the methodology using the phrases "material increase in costs" and "material increase in risk" interchangeably; for instance

"*The network will be re-analysed to see if there are any material increases in costs, i.e. over and above any forecast with the existing obligated levels. If there are* ***no material increases in costs*** *it would indicate that under this supply and demand scenario it would be possible to undertake trade and transfers at a 1:1 exchange rate up to existing obligated levels without a probable* ***material increase in risk***."

It would be more helpful if the methodology described exactly which costs (or risks) are being assessed and in what context. For example, if the mechanism caused additional compression to be needed then there could be an increase in costs to NG NTS; however, the benefit to the market of additional gas delivery may outweigh the compression cost.

Setting of the 'ZAM'

It would be much more transparent and auditable if the ZAM is set at the zonal baseline. If NG NTS can demonstrate that this approach materially increases its buy-back risk relative to the assumptions used in setting the TPCR, then an adjustment could be made to the buy-back incentive.

In Paragraph 31(ii), it is stated that the ZAM is likely to be determined by test scenarios. It is not clear how extreme will these test scenarios be. There appears to be a lack of transparency in respect of what NG NTS will assume here and so it would be beneficial if NG NTS could publish the scenarios it will use.

Setting of the 'cap'

We strongly believe that the proposed cap of 150% of obligated entry capacity (paragraph 20 (a)) should be removed. We believe it is an arbitrary, unproven figure and inconsistent with the aim and objectives of a trade and transfer process which is to facilitate the efficient and economic re-allocation of entry capacity to where it is valued most. Ultimately, the imposition of an artificial cap will place a constraint on the total amount of capacity that can be transferred using the trade and transfer process.

If the cap is being used to control buy-back risk, then it would seem much more economic and efficient to base the NAM purely on actual network analysis and modelling. The explanation in the methodology for the use of the 150% figure is that this is used in the QSEC auctions as 'the default maximum percentage of existing obligated entry capacity available for Users to signal their requirement for incremental demand". However, as NG NTS will be aware, the '150%' used for the QSEC is a default figure in the IECR which is not fixed and can be changed at the request of Shippers. We therefore fail to see any justification for the imposition of the 150% cap. If the 150% cap has been agreed with Ofgem as part of the TPCR package then this should be made clear in the consultation. If not, we would welcome additional analysis and evidence on the suitability of the 150% figure.

Setting of the 'NAM'

Paragraph 20 (a) Use of the minimum historical demand for a month may cause the method to be driven by exceptional circumstances. We suggest that minimum demand for a typical month / seasonal nom will give more consistent and predictable results. In addition, where flow has historically been above the NAM then the NAM could be increased to that flow, unless other constraints are reached.

Paragraph 20 (b). We do not support the proposal to limit the NAM to the max historical flow from the last five years and we are concerned by the suggestion that these limits are also confidential. Where the constraint is within the terminal itself, that constraint should be managed by the terminal operator through the contractual arrangements it has with Shippers to use that terminal. Where the constraint is an NTS constraint, we would question why that should be confidential?

Definition of "Zones"

Reference to the use of an east coast "super zone" has been frequently made in recent entry capacity baseline review meetings. If this zone was used to set current baselines, upon which trade and transfer is based, then we are unclear why such a "super zone" was not also adopted for trades and transfers? The use of a single east coast super zone could reduce significantly the number of exchange rates and combinations for inter-zone transfers and aid clarity in terms of intra-zone transfers. This however, is clearly a very significant change to the proposed methodology so is perhaps better addressed through the longer-term enduring arrangements.

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

Richard Fairholme (by email)
Trading Arrangements
E.ON UK