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30 September 2009

Dear John,

**RE: Gas SO Incentives Consultation 3 – Operating Margins: Contestability Update & Incentives**

E.ON UK believes there is merit in a continuation of the revised Operating Margins (OM) tender process, which was previously widened to include a more diverse pool of potential providers. Last year, it was our understanding that the primary purpose of the revised tender was to demonstrate that contestability existed. To a degree, we believe that was proven; evidenced by National Grid accepting offers for OM services outside of the pool of historical providers. However, we note that this was for “proof of concept” purposes and in addition to the minimum OM requirement; rather than as a direct substitute for previous providers.

Evidently, the potential for further competition depends on the HSE’s approval of National Grid’s revised Safety Case, the outcome of which we understand will not now be known until late 2009. We note that this gives those wishing to tender in 2010 very little time to prepare if the tender takes place in January, as it did in 2009. Given the uncertainty and rather last-minute decision making, we are concerned that potential providers may be discouraged from participating in the tender. Furthermore, we are concerned by the statement in the consultation paper that National Grid “...are endeavouring to work towards timescales which would facilitate a decision by the HSE in advance of the Operating Margins tender period”. We believe that it should be of utmost importance that this is resolved before the tender, in order to maximise the potential participation by National Grid’s customers.

In previous responses, we also raised concerns regarding the monopoly position of certain National Grid LNG sites in providing OM services and note that this is still the case for certain

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locations on the NTS. For instance and as highlighted in the consultation paper, Glenmavis is in a hugely dominant (virtually monopoly) position in the provision of the Scotland locational OM gas requirement. As a result, unless the strict OM requirements are slackened to include a broader range of potential providers (which presumably would require further changes to the Safety Case), NG LNG is almost certain to have its offers accepted, regardless of price. This point is recognised in para 66 of the consultation paper, which notes that the cost of OM provision would have doubled from £18m to £37m had Ofgem suspended the regulated prices for NG LNG Storage in 2009. This significant increase is of concern to Shippers and could also have had unfortunate consequences for consumers, who may have been forced to pick up the increased costs due to the cost pass-through proposal. Therefore, given the dominant position of NG LNG at certain locations on the NTS, it may be suitable for Ofgem to only suspend regulated (“C3”) prices at points on the network where competition between providers is actually possible. However, this may have wider competition implications and therefore should be considered carefully by the Regulator. Regardless, we believe that an early indication and/or decision on this matter is needed very quickly from Ofgem.

I hope that the above comments prove useful. Should you wish to discuss our response in any further detail, please do not hesitate to contact me on T: 02476 181421.

Yours sincerely,

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