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Dear Robert

Thank you for giving us the opportunity to comment on the latest transmission price control proposals. E.ON UK is responding primarily in the capacity as a major user of both the gas and electricity transmission systems.

E.ON UK continues to be concerned that the TPCR is being used as a vehicle to promote radical and in our view often unnecessary change to the transmission access regime in both gas and electricity. We consider that Ofgem would find it difficult to justify many of these suggested reforms without this linkage to the TPCR.

We accept that incremental change is required in a number of areas to address specific concerns related to the efficient expansion of the networks, and these are the areas where the industry needs no inducements to suggest changes to the trading arrangements. For example the latest NG Final Sums Liability (FSL) proposals for new generation connections are based on industry suggestions and offer a means of underwriting system reinforcement and protecting against 'stranded assets' whilst avoiding placing unreasonable liabilities on project developers, which might otherwise dissuade such investment. On the other hand it is noticeable that users have not put forward radical and complex changes to gas NTS exit regime because they see very little if any justification for the so called "enduring offtake arrangements," a concept that has been widely opposed by the industry and customers alike, ever since such ideas were first mooted by Ofgem as part of the gas DN sales process.

In our view changes to access terms should be pursued through the established 'user facing' industry code governance processes, i.e. the UNC in gas and the CUSC in electricity. It is these governance arrangements that provide code users with the comfort that their interests will be formally considered. Unfortunately, code users necessarily find themselves as junior parties in the TPCR debate. In practice this means price control negotiations between NG and Ofgem can drive changes to market arrangements or dictate future changes to market arrangements (e.g. through application of 'conditional' licence conditions on NG to bring forward

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particular proposals) which can in effect 'prejudge' the outcome of Ofgem decisions on code modification proposals.

With the view to successfully completing the TPCR negotiations in a timely manner we would urge Ofgem to rethink many of its more radical user commitment ideas for the use of the gas and electricity transmission systems. We consider that simpler arrangements should be adopted in response to the requirements of users, and that Ofgem should only progress proposals that can be clearly justified. E.ON UK would welcome the opportunity to discuss with Ofgem and NG how best to progress incremental changes which in our view should;

- 1) Build on the progress made on FSL obligations in electricity.
- 2) Retain the existing capacity booking mechanisms for booking exit capacity in gas and transmission entry capacity (TEC) in electricity.
- 3) Consider (with caution) new substitution arrangements for the sale of gas entry capacity.
- 4) Establish new cost reflective charges for gas DN offtake flexibility to provide signals for appropriate incremental investment by DNOs in network flexibility.
- 5) Continue to allow other NTS connectees to continue to book bundled (flat and flexibility) capacity although by exception (i.e. rarely) the amount of NTS flexibility may need to be rationed via a day ahead/within-day auction on 'difficult' days.
- 6) Incremental investment for gas exit and electricity entry to be underwritten by advanced reservation of capacity (ARCA) and FSL obligations. There is no need for longer-term booking of capacity (i.e. greater than one year).

Our more detailed comments on the respective electricity and gas price control reviews are set out below.

Electricity Transmission Price Control Review

We are not readily in a position to comment on many of the issues raised in the consultation such as forecasts of capital expenditure and operating costs, or the correct cost of capital to use for the companies. As a major user of the transmission system we are concerned foremost with how these issues manifest themselves in the services we receive from the transmission licensees and the charges we pay for these services.

In our response to the previous consultation we outlined our concerns regarding the proposed user commitment models for access. As this latest consultation does not cover transmission access arrangements specifically we do not propose to comment further in detail on this issue in this response. We note however that National Grid's latest proposals for the calculation of FSL also include a longer term commitment to paying TNUoS charges for existing generators than presently exists. We continue to believe that such a commitment is both unnecessary and undesirable. We will present these concerns as and when the relevant code changes are raised.

Two issues raised in the latest consultation document on which we specifically wish to comment, are the proposed use of revenue drivers for incremental capacity release and the assumptions outlined on pages 33 and 34 of the main document regarding connection designs for wind generation.

We support the use of revenue drivers, but believe that care must be taken in their construction and operation. For instance, it is important that they do not place incentives on the transmission companies to delay infrastructure projects which are necessary to accommodate new generation connections. Investment in the networks is often undertaken in relatively large increments compared to the

amount of capacity which it is meant to accommodate, at least in the short term. Therefore, it is possible that a revenue driver which pays an amount per MW of generation capacity will not immediately release sufficient revenue to cover the cost of the relevant reinforcement. This could put an incentive on the licensee to allow projects to stack up before undertaking the work, causing an unnecessary delay to some projects.

As revenue drivers are only a proxy for the cost of new investment at best, it is important that they are not overused. Therefore, correctly setting the baseline capacity, over or under which the drivers will be used, is important. Revenue drivers for instance should not be used to fund the entire capital expenditure of a licensee. Neither should the baseline expenditure be significantly overestimated and the revenue drivers relied on to pull back the allowed revenue to the correct level of generation. Revenue drivers should be used to fund incremental changes which could not be reasonably foreseen.

Question 7.3 asks whether respondents agree with the assumptions on the efficient connection design for wind connection and the implications for the licensees' cost projections. Whilst we cannot comment on cost implications, we are concerned that Ofgem's assumption seems to imply that wind projects will as a matter of course be offered less secure connection designs. Generators should always be offered a normal standard of security, but if they wish to opt for a lower standard then this should be entirely their decision. Choosing such a connection for instance may mean that they will be able to connect earlier than if a standard connection was offered, or may allow them to address planning issues that would otherwise arise. However, if a generator does accept a less secure connection we would expect that it would not be compensated should its operation be constrained. Otherwise, other network users would be subsidising its decision to opt for a lower standard of connection.

It also appears from the document that lower charges are being contemplated for these Users to reflect the lower level of security. This must be considered very carefully. For instance, by how much would the charge have to reduce to accurately reflect the reduction in security? Additionally, it should be considered whether the generator has already sufficiently benefited from the earlier connection date or by addressing planning concerns. If an undue incentive is created to opt for less secure connections this may reduce investment costs, but result in a reduction in security of supply and an increase in balancing costs, as other generation is required to replace constrained plant.

Gas Transmission Price Control Review

Chapter 11 Adjustment mechanisms and incentives: gas

11.1 What do you think of our revised proposals for setting entry capacity release obligation baselines, and for the proposed mechanisms for enabling such baselines to be re-allocated in some circumstances?

E.ON U.K. welcomes the revised proposals for setting entry capacity release obligation baselines. We set out our reservations with NG releasing capacity at their discretion in our original response and it is encouraging to see that Ofgem have taken stakeholder's concerns on board and revised proposals accordingly.

Making available specified volumes of capacity at each entry point provides certainty to shippers and whilst we recognise that this may raise the issue of inflexibility, this must be balanced against the potential for added complexity and a reduction in certainty, through reallocating baselines between entry or offtake points. Once we have seen NG methodology for identifying and proposing appropriate substitutions, we will, of course, be better equipped to comment but

until we have seen such a methodology, it is difficult to provide a meaningful view as to whether it is or is not an appropriate framework. It is important to ensure that all capacity is made available but this must be sufficiently weighed against the consequent reduction in certainty.

11.2: Are our proposals for the revenue drivers for entry and offtake appropriate and proportionate, given the issues they are seeking to address?

We agree that NG should receive appropriate remuneration for additional capacity over and above baseline levels. For significant requests for incremental or new capacity triggering investment, we would argue that the current ARCA mechanism provides NG with the appropriate degree of certainty where additional capacity will be demanded. We remain unconvinced that the current offtake regime has significant enough failings to justify enduring reform as NG have stated in previous EOWG meetings, no stranded assets have been identified on the system, to date.

Appendix 16: Offtake revenue drivers and baselines for NGG NTS

A16.1 Do you agree with our initial proposals for the transitional period with respect to:

a) baseline levels?

We generally agree with this approach.

b) revenue drivers?

We generally agree with this approach.

c) NGG NTS incentives

We generally agree with this approach.

A16.2 Do you agree with our initial proposals for baselines in the enduring period including the adjustments proposed?

We broadly agree with the initial proposals for baselines in the enduring period, in that they should be determined on a nodal basis, reflecting existing capacity levels. As noted earlier in this response, whilst we recognise the importance of making all capacity available, this must be considered in light of the added complexity brought about through a substitution obligation. Ensuring a transparent methodology for identifying and proposing appropriate substitutions is published, will alleviate some concern. It seems most appropriate, however, to ensure good governance, that any such methodology should be included in the UNC.

We remain concerned with the removal of interruptible sites as they exist under the current arrangements, and the impact this will have on system security, through removing an important NG tool to manage the system on difficult days. Furthermore, the incentive on Users to install distillate at new power stations or for large industrial users to install back-up supplies might be weakened through the loss of interruptible benefits. The willingness for these customers to offer demand response at times of system stress will be impeded if they have no back-up supply to revert to and this may have a significant and negative impact on system security going forward. With the Large Combustion Plant Directive on the horizon and the associated increase in CCGT plants likely to be built, it is important to ensure that these sites are appropriately incentivised to install back-up capabilities.

A16.3 Do you agree with our initial proposals regarding the introduction of a substitution obligation on NGG NTS?

As noted earlier, we agree with the concept but benefits must be weighed against

the added complexity and uncertainty, which this will give rise to.

A16.5 Do you agree that our proposals for addressing entry / exit interactions are appropriate?

It seems sensible that exit baselines are increased to reflect investment at entry or vice versa.

A16.6 Do you agree with our proposals with respect to buy backs of offtake capacity?

We agree that investment related buy-back costs should be treated as excluded revenue to ensure that NG is appropriately incentivised to deliver in a timely manner. Any flexibility allowed to NG, with regards to investment lead times should be treated with caution so as not to weaken incentives to invest in a timely manner.

We welcome the move away from an administered buy-back price set a year in advance but consider more work needs to be done to ensure that the cap proposed goes far enough to reflect the true value of that gas on any given day.

A16.7 Do you agree with our initial proposals for financial incentives on NGG NTS with respect to the release of non-obligated interruptible capacity?

We agree with proposals for financial incentives on NG to release available capacity day ahead and within day. We look forward to seeing the details of this incentive, in particular surrounding the discretionary release, and the pricing of such products.

Appendix 17: Draft enduring offtake impact assessment

A17.1: What are your views on the benefits analysis conducted?

It is our opinion that the benefits outlined in the impact assessment are highly overstated and analysis feeding into the assumptions is lacking. E.ON chose not to provide cost data for this impact assessment because we considered at the time that the enduring offtake arrangements were insufficiently defined to enable us to provide a meaningful submission.

We remain unconvinced that there needs to be consistent arrangements between DNs and TCCs, in order to avoid undue discrimination. Indeed we consider it to be discriminatory to treat different types of user with entirely different characteristics on an identical basis. Attempting to resolve some of the perceived issues on a 'one size fits all basis' creates unnecessary complexity. Whilst we welcome the discussions through EOWG and believe they have been helpful in considering potential options, fundamental reform appears to be being forced on the industry even-though more pragmatic, incremental changes potentially offer a lower cost way forward. NG has openly stated in the EOWG that there are no known 'stranded' assets on the system at present and there have only been three disputed ARCAs and whilst we accept that the number of ARCAs will increase as more CCGTs are built, we do not consider that a case has been made to suggest that the number of disputed ARCA will increase if the existing arrangements continue. Furthermore the cost of regulatory determinations is unlikely to be high, unless of course Ofgem decided to move away from the "shallow reinforcement policy" which was reaffirmed by its Langage determination.

We are also unconvinced that enduring offtake reform could lead to more flexibility being offered into the electricity balancing mechanism. Flexibility is inherent in the system and so any new arrangements to incentivise users to book it as a separate

capacity product and potentially incur overruns would lead to one or two potential consequences; either the user effectively books the same amount of capacity as under the current arrangements but pays more for it, the costs of which would likely pass through to electricity customers, or, the overrun charge and payment for capacity incentivises the user to book less flexibility and, therefore, offer less into the electricity balancing mechanism, increasing system operator balancing costs.

A17.2: What are your views on the cost analysis conducted?

We find it very difficult to understand or accept Ofgem's reasons for dismissing the outliers at this stage in the process, owing to a majority of one in the lower cost estimates. Evidently, only five TCC shippers felt they were in a position to be able to estimate costs, we would assume this was owing to the significant uncertainty remaining, with respect to the proposals for enduring reform. The lack of certainty and constant change to proposals being considered reflects the complexity of the options for reform and the difficulty for industry participants to reach a workable solution that fits for both GDNs and TCCS. We anticipate that a number of options will be considered going forward, including the AEP suggestion of an OPN based approach for purchasing flexibility on difficult days, with the associated business rules and information on how such products might be priced, to facilitate fuller understanding and enabling industry participants to submit accurate cost estimates for a suite of options. We are strongly of the opinion that incremental changes to enable the transporter to better manage the system on tight days would be the most economic and efficient means of addressing some of the flexibility issues, identified by Ofgem.

If you wish to discuss the views expressed above please do not hesitate to contact Christiane Sykes for gas transmission issues or Paul Jones for electricity transmission issues. Alternatively please give me a call.

Yours sincerely

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