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

Dan Meredith
024 76183115

daniel.meredith@eon-uk.com

Sonia Brown
Director, Wholesale Markets
Ofgem
9 Millbank,
London
SW1P 3GE

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Re: Ofgem Consultation 163/06:

Regulatory arrangements for the new Dutch-GB electricity interconnector - E.ON UK Response.

E.ON UK welcomes the opportunity to respond to this consultation. The following answers to Ofgem's specific questions contained within the consultation document represent our response:

Question 1

Do you agree with our overall assessment that the exemption should be granted based on the examination of whether the exemption criteria have been met?

In the main yes, although we are uncertain of whether Article 7(1)(f) of the Regulation is fully met. We note in the economic assessment submitted in support of BritNed's application for exemption that it believes that the access arrangements will have an identical effect on competition as those which would pertain if an exemption was not granted (please see the formal logic expressed on page 3 of the study). However, we do not agree with this statement. This is because the submissions made by BritNed appear to imply that certain of the proposed access products will be subject to some form of reserve price.

For instance, on page 14 of the BritNed's application for exemption, it is stated that one of the conditions of the implicit auctions to be operated will be that "*no trade should be carried out by APX unless the price difference between the two markets is sufficient to pay for the estimated trading costs*". There is a suggestion further on this page of the document that these trading costs would reflect electrical losses on the link. However, there is nothing which explicitly states that this will be the total extent of these costs. Similarly, there appears to be nothing in the draft exemption order or the draft interconnector licence which specifies that such trading costs will be set solely on this basis. Therefore, there would be nothing to prevent BritNed setting a higher reserve price should it so wish.

We note that BritNed also proposes to introduce a reserve price for the intra-day access arrangements. This is more explicitly stated in the second paragraph of page 17 of its application for exemption:

"*In line with clause 2.9 of the draft Congestion Management Guidelines, a (minimum) price for intra-day allocations will be established. BritNed, will develop a mechanism for calculating this minimum price*"

Although establishing a reserve price as described is not contrary to clause 2.9 of the Congestion Management Guidelines, it should be recognised that the removal of a reserve price would be in line with the clause too. This is because clause 2.9 merely says that the reserve prices are prohibited except in the case where an exemption from rTPA has been granted. It states:

"*Other than in the case of new interconnectors which benefit from an exemption under Article 7 of the Regulation, establishing reserve prices in capacity allocation methods shall not be allowed.*"

Therefore, if the intention of BritNed is to put in place access arrangements identical to those which would be required if an exemption had not been granted, it would not introduce any products which include a reserve price. Reserve prices are detrimental to competition as they reduce the level of trading which can take place over the relevant interconnector. Trading parties have long argued for their removal from the access arrangements for existing interconnectors. This has been recognised in the drafting of the congestion management guidelines.

Therefore we do not believe that the application fully meets the requirements of Article 7(1)(f) of the Regulation. We would recommend that BritNed should be required to implement an access regime which does not include reserve prices, or provides only to cover losses, and that this should be made an explicit condition of the granting of the exemption.

Of course, it may be deemed by Ofgem that the exemption should be granted as the existence of the BritNed interconnector with an exemption would be preferable to no link at all. Therefore, if the project requires a reserve price to enable it to proceed then it may be deemed a price worth paying. However, we are not in a position to make this evaluation as we are not privy to the relevant information.

We would suggest that Ofgem really tests this point with BritNed. The economic study suggests that BritNed's concern is that requiring the link to be subject to rTPA requirements would mean that it runs the risk that profits will be capped, whilst there will be no limit to the downside to which it can be exposed. However, BritNed appears to want to implement arrangements which restrict its downside exposure whilst placing no restriction on the amount of profit it can make. We would argue that both situations are inequitable which is why we would suggest that the removal of reserve prices should be a condition of the exemption as suggested above.

Question 2

Given the lack of clarity in the application surrounding the arrangements for dealing with the differences between the balancing periods in the markets in Great Britain and the Netherlands, do you have views on what the most appropriate form for such arrangements should be?

Notwithstanding our comments above regarding reserve prices, we believe that the proposed arrangements should be more tightly defined before an exemption is approved. For instance, the basis on which capacity would be allocated between different products should be more explicitly stated rather than to rely merely on adjusting the proportions in response to market demand. This is particularly important when some capacity is to be made available for TSO to TSO trading as proposed.

Indeed we are concerned by the general proposition that TSOs will be trading energy in this way. Similarly, we assume that National Grid and TenneT will be explicitly prohibited from participating in the proposed APX day ahead auction arrangements. We note that the competition assessment states that neither TSO has any generation interests in the markets at either end of the link. However, National Grid does purchase and sell energy for balancing purposes in the GB market and could presumably wish to do so through this mechanism. However, we believe that it would not be acceptable to put National Grid in a position where it could set prices in this auction mechanism, when it would also benefit through its shareholding in BritNed from any congestion revenue which was generated as a result. Indeed, given that that National Grid has greater access to market information than other market participants and is able to operate in timescales beyond gate closure, it is arguably in a stronger position than generators in this respect.

In terms of how the different settlement periods of the two markets could be handled within the proposed implicit auctions, we assume that trades will have to be carried out on an hourly basis. This means that from a GB perspective hourly strips of two GB periods would be traded. This would not be ideal, but would avoid wholesale changes to the national trading arrangements of either country.

Question 3

Do you agree with the proposed scope and duration for the exemption, and the conditions for revocation?

We are not in a position to comment on how long BritNed requires the exemption in order to fulfil its business model. Presumably, this will be something that Ofgem will review carefully along with whether the arrangements for access need to include reserve prices.

Yours sincerely

Dan Meredith
Regulation and Government Affairs
Strategy & Energy Policy
office: **02476 183115**
mobex: **777-2563**
mobile: **07876 445181**
daniel.meredith@eon-uk.com

e·on | UK