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Mr Robert Hull
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Ofgem
9 Millbank
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Monday, 23rd July 2007

Dear Robert,

RE: Entry Capacity Substitution Licence Obligation

E.ON UK does not support the imposition of a capacity substitution obligation to take effect pre-winter; i.e. to apply to the forthcoming QSEC auction. We are generally supportive of the capacity substitution obligation, but believe it would be most pragmatic to delay implementation until 2008.

In contrast to the trades and transfers obligation, which has been discussed and debated within the industry for well over a year now, there has been a distinct lack of dialogue on the issue of capacity substitution. As a result, we believe that proposals on this critical subject have been left until the last possible moment, which has created significant regulatory uncertainty and unease in the market.

In considering the implications of imposing a capacity substitution obligation pre-winter, we have taken into account the potential for NG NTS to gain unduly, or reduce their risk, by delaying implementation of this specific Licence obligation. In contrast to the trade and transfer obligation, we do not see that delay until 2008 would be to the detriment of the economic and efficient operation of the NTS or the wider market.

As we rapidly approach the September QSEC auction, it is very apparent that there are a significant number of major changes to the structure of this particular auction: For instance, new reserve prices introduced following NTS GCM 01 and a new Incremental Entry Capacity Release statement / methodology. With each layer of complexity added, it becomes increasingly difficult to assess the impact of the individual changes. Equally, it is

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becoming increasingly difficult, from a User's perspective to understand how to bid effectively with so many concurrent changes. Whilst we remain supportive of a capacity substitution obligation in general terms, we do not feel it is appropriate to rush through very significant changes so close to the QSEC auction; particularly where there is no harm done by delaying imposition until 2008. As demonstrated by the number of Modification Proposals raised in relation to the trade and transfer of entry capacity, such complex issues invariably require development and refinement before they become acceptable to the industry. With this in mind, the significant confusion and unnecessary uncertainty that could be introduced by imposing a pre-winter obligation, thereby necessitating urgent and potentially under-developed Modification Proposals, could be very damaging to the continued efficient operation of the market.

Finally, it is important to note that the effect of a trade and transfer of capacity is transitory (i.e. transferred for a month, then reverts), but the effects of substitution are <u>permanent</u> and long-term. It is, therefore, more important than ever to ensure the solution is effective and fully evaluated by the industry before implementation. We do not believe this is achievable in the short space of time remaining.

I do hope you find our comments useful.

Yours sincerely

Richard Fairholme (by email)
Trading Arrangements
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