



Bogdan Kowalewicz  
Gas Transmission  
Ofgem  
9 Millbank  
London  
SW1P 3GE

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

Richard Fairholme  
Trading Arrangements  
T: 02476 181421  
richard.fairholme@eon-uk.com

22<sup>nd</sup> May 2009

Dear Bogdan,

**RE: Proposed disposal of part of NTS for Carbon Capture and Storage**

E.ON strongly believes that, alongside other ways of lowering carbon emissions, Carbon Capture and Storage (CCS) technologies are crucial to the successful delivery of our energy policy aims. Across Europe, E.ON is heavily involved in the development of CCS technologies through research and pilot projects. In the UK, E.ON is also developing a new supercritical coal-fired power station to replace the original coal-fired plant at Kingsnorth, Kent. This plant is entered into the Government's competition to gain support funding for a commercial scale demonstration of CCS technologies.

**CHAPTER 2: Proposal to dispose of assets for CO<sub>2</sub> transportation**

**Question 1:** *Do you think this proposal is a good idea in principle?*

We support the principle behind this proposal by National Grid, but have some concerns about the possible impacts if implemented. As a holder of gas shipper licences under the UNC and as a major user of the gas National Transmission System (NTS), we consider that further analysis is required in a number of areas, in order to demonstrate that this proposal will not have detrimental effects on the access rights of shippers or the best interests of gas consumers.

E.ON UK plc  
Registered in  
England and Wales  
No 2366970  
Registered Office:  
Westwood Way  
Westwood Business Park  
Coventry CV4 8LG

**Question 2:** *In the event that a feeder section is removed, existing compressors may be required to work harder to transport the same volumes of gas through fewer pipes. It is proposed to capture these additional compressor fuel costs and to introduce a capped volume for these additional fuel costs, based on pre-disposal levels, over which the new CO<sub>2</sub> transportation business would bear the costs and make payment to NGG. What is your view of this proposed treatment of these additional compressor fuel costs?*

NTS compressor fuel costs are currently accounted for in the gas SO shrinkage incentive arrangements. The shrinkage incentive includes the gas (and more recently, electrical energy) which is used in operating NTS compressors. Clearly, in order to avoid a cross-subsidy, additional compression costs (either gas or electrical) resulting from this specific project must not be passed through to gas consumers.

It is suggested in the proposal that a cap on costs may be the answer; however, there is likely to be difficulty in implementing an 'absolute' cap on costs, not least because compression fuel usage varies significantly according to system throughput. It is also our understanding that there has been a dramatic reduction in the use of compressors on the NTS and that this is expected to continue. Therefore, Ofgem should think very carefully about how to set a cap which would be based on "pre-disposal levels", since this may not necessarily be an accurate guide to future usage levels. If the cap is set too high, gas consumers will be cross-subsiding the CCS project through increased transportation costs. Conversely, if the cap is set too low, the significant compression costs payable to National Grid by its CCS subsidiary may make the project economically unfeasible. Further analysis will, therefore, be required to ascertain the best means by which to measure and control 'additional' compressions cost as a result of this project.

### **CHAPTER 3: Regulatory issues**

**Question 1:** *Do you agree with our view of the regulatory issues of the proposed asset disposal?*

The main regulatory issues seem to have been broadly captured.

**Question 2:** *Do you agree with the projected forecast flows at St. Fergus?*

**Question 3:** *Are there other flow forecasts or scenarios which should be taken into account?*

We note the flow forecasts are consistent with National Grid's Ten Year Statement, but that the views of stakeholders involved in new projects such as those related to the 'West of Shetland' and possible Norwegian imports will need to be taken into account. The review of entry capacity baselines in 2007/8 underlined the importance of wide stakeholder consultation in order to seek to avoid unintended consequences.

**Question 4:** *What is your view of the indicated capability at St. Fergus with the feeder removed, with and without additional compression?*

**Question 5:** *What is your view of the projected buyback costs which have been identified?*

This is an area which requires specialist knowledge of the network and access to all the relevant system information, which is something that, as a shipper, we do not have access to. In order to get a robust answer, therefore, Ofgem should subject these assumptions to external scrutiny.

**Question 6:** *Are there any other issues that you believe are relevant?*

The impact of this project on system-wide 'flexibility' and linepack has not been sufficiently covered in this initial consultation and merits further work; particularly in light of recent Ofgem proposals to consider the role of 'flexibility' at both entry and exit and a review of National Grid NTS's constraint management tools.

**Question 7:** *What is your view of the proposed disposal of these assets?*

The proposal is not an unreasonable one, but requires much more evidence to demonstrate that ultimately, gas consumers will be getting fair value for money and that shipper access rights to the NTS will not in any way be compromised.

#### **CHAPTER 4: Valuation of assets**

**Question 1:** *Do you agree with the possible ranges of valuations for the assets which have been identified?*

**Question 2:** *Do you agree with the assumptions which underpin the asset valuations?*

**Question 3:** *Is there an alternative method of asset valuation which should be considered?*

**Question 4:** *Do you agree with the assessment of benefits associated with asset disposal and alternative use?*

**Question 5:** *Are there any other considerations that should be taken into account?*

These are all specialist issues on which Ofgem should obtain expert advice.

## **CHAPTER 5: Commercial options**

**Question 1:** *Do you consider that the opportunity to potentially share in the benefits of CCS using ex-NTS assets represents an appropriate balance of risk and reward?*

We do not believe that the case has yet been sufficiently made that gas consumers would wish to be exposed to the risk of increased costs through the gas buy-back arrangements, as a direct result of this CCS project. Since this is the first time that NTS pipelines will have been used to transport CO<sub>2</sub>, there are a number of unknowns and risks to the success of the project. It may be sensible therefore, to only expose consumers to some the risks (and rewards) through a sharing mechanism once the project has been implemented and its success proven.

**Question 2:** *What is your view of a lump sum payment, in the event that consent is granted for disposal?*

Given that under this option “*There is no exposure to shippers as baselines are preserved and the buyback risk is covered by the National Grid subsidiary*” and “*Shipper charges would be reduced as a consequence of the reduced RAV, following the change in use of the asset*”, this would seem to be the lowest-impact option for Shippers (and gas consumers). However, in order to deliver fair value for consumers, it will be critical that the value of the asset is robustly calculated and subjected to expert scrutiny.

**Question 3:** *What is your view of a participatory royalty arrangement, in the event that consent is granted for disposal?*

Since the “basic royalty” option does not include any exposure to buyback costs for shippers, we believe this may be the most beneficial approach to begin with. It avoids difficulties with finding the ‘right’ value for a lump sum payment approach because it takes into account the extent to which the asset is re-used in terms of quantities of CO<sub>2</sub> transported.

The “participatory royalty” appears to expose gas consumers (via shippers) to a significant amount of risk, since constraint costs have the potential to vary significantly from forecast – particularly in the long timescales being discussed here. Additionally, given it is proposed that the buy-back risk would be offset by the royalties from transportation of CO<sub>2</sub> in the pipeline, this approach exposes consumers to further risk if the pipeline is used less than forecast or the project is delayed, which may mean ultimately that the project makes a loss. Clearly, exposing consumers to risk in this way would not be consistent with Ofgem’s role of protecting the interests of consumers.

The “participatory royalty” model may be more suitable once the project is successfully implemented and the business is demonstrated to be a stable and profitable one in which Shippers may wish to consider participating in.

**Question 4:** *Are there other risks / benefits which should be taken into account?*

It is stated by Ofgem that “*these options have been developed on the basis that baselines will not change as a result of the disposal of the feeders from NGG.*” Whilst this may be true for the remainder of the current price control period (2007-12), we do not believe that either Ofgem or National Grid can say with any certainty that baselines (particularly at St. Fergus) will never change in the future. Indeed, we find it quite surprising that National Grid feels able to dispose over 300km of NTS pipeline and yet be able to guarantee that there will be no impact on baseline obligated entry capacity. This surely brings into question the accuracy of not only the St. Fergus, but all other NTS baselines and whether they too have headroom that could be made use of without the need to build new capacity.

I hope that you find these comments useful. If you wish to discuss any aspect of this response in further detail, please do not hesitate to contact me on the number above.

Yours sincerely

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