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Gas Distribution Price Control Review – 3rd Consultation Document

Dear Joanne,

We appreciate that your consultation document is principally aimed at Gas Distribution Network owners, Independent Gas Transporters and consumer representatives however we have taken the opportunity to provide our views as a prominent integrated energy company operating in the UK. Our activities include gas shipping and supply and the costs and cashflow of these are materially affected by gas distribution charges.

We have endeavoured to provide an overview of the principle areas of interest for us within your consultation rather than answer your specific questions.

Xoserve

We believe that an incentive mechanism is required for the Gas Distribution Network (GDN) owners regarding xoserve to ensure this important industry asset provides as much value as possible.

Xoserve operates in a unique position within the market acting as a central provider of services that helps facilitate the competitive downstream gas market in Great Britain. They have the potential to deliver significant value to industry participants and to enhance the level of service that gas and potentially electricity customers receive.

However the current ownership structure of xoserve does not create the correct motivational environment for this potential to be realised. To change the mindset and environment we believe that this ownership structure will need to be eventually addressed.

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The option suggested by Ofgem for the funding of xoserve during the next price control period will start to address the structural issues with xoserve and eventually should allow for the ownership question to be resolved relatively easily. This would allow the question of whom xoserve contracts to provide services for to be debated more easily.

Capping the allowed revenue for these services below the required amount; combined with allowing the GDN's to profit from any additional services that xoserve provide to the industry as excluded revenue, should provide a suitable incentive for the GDNs to change the behaviour of xoserve. We therefore support Ofgem's suggestion within this consultation with regard to the potential funding for xoserve over the next price control period as we believe that this should implement a suitable incentive scheme.

Strict supervision by Ofgem of the profits that xoserve make on their activities will need to be maintained to ensure that shippers, suppliers and gas consumers are not detrimentally affected during this transition phase.

Information transparency & predictability of charges

Of paramount concern to our retail business is the ability to understand and predict with some certainty the level of charges that will be incurred from gas transporters.

We would prefer GDNs to provide more information that would help to predict transportation charging more easily. We have recently seen electricity distribution network operators implement regular reporting and believe that this could be replicated for the gas distribution businesses. In particular we would like to see:

1. An indication of over/under recovery throughout the year and between price control periods

The information provided by the GDNs at the moment is inconsistent and could be improved. Guidance from Ofgem may help them provide this on a more regular and user friendly format.

2. Build up of over/under recovery throughout the year and between price control periods and the lack of visibility of performance against Capex/Repex allowances.

The considerable overspend that was reported by GDNs came as a surprise to shippers and has contributed to lack of predictability in gas transportation charges. Additional visibility regarding this information would assist shippers/suppliers in predicting future charges.

Price variability

Variability of prices is an important issue for suppliers when setting tariffs and contract prices for customers. It is costly and difficult for gas suppliers to vary their customer contracts to take into account widely varying gas transportation costs. Therefore widely varying gas transportation costs, as has been seen recently, will lead to increased risk premiums being applied to the price that customers pay for gas.

We would therefore support moves such as the alignment of transportation charging changes to Formula Years compared to Gas Years if this could be demonstrated to reduce the variability of charges.

Adoption of existing private networks

There are a number of prime and sub-meter configurations in Great Britain that are a legacy of efficient network development during the monopoly British Gas era.

The ownership and responsibility of the gas network between the primary and sub-metering is in dispute and needs to be resolved. The existence of sub-metering configurations on GDNs creates difficulties and problems in the operation of the shipping and supply markets.

These arrangements should also be considered when discussing the impacts of adopting existing private networks

Opex rolling incentive

We support the principle that incentives should maintain their strength over time. A rolling incentive ensures that companies are equally rewarded for efficiency savings throughout the price control period and sends a strong message to companies to pursue efficiency with constant vigour irrespective of position within the price control cycle. It is recognised that robust accounting rules support the integrity of rolling incentives. Investors are reassured by longer term

certainty and a rolling incentive helps to create this.

We believe it imperative that such a principle should also be applied across other incentive mechanisms within the price control, such as network performance and losses, as well as the existing rolling mechanism for capex efficiency.

Network Extensions

We would support a scheme that incentivised GDNs to extend their networks to areas not served by mains gas as this should help to alleviate fuel poverty. Any incentive scheme should not result in complex charging structures for shippers/suppliers to administer and should be easy for customers to understand.

If extending the gas networks primary objective is to help address fuel poverty it may be worth exploring the possibility of including priority criteria on network extensions to benefit the fuel poor. The government has data on the concentration of fuel poor and this could be combined with off-network areas to determine which areas should be prioritised.

Yours sincerely

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