Our Ref 63/06
Your Ref

Robert Hull
Transmission
Ofgem
9 Millbank
London
SW1P 3GE

Date 12 May 2006

Dear David,

Proposed Incentive Arrangements for the Provision of NTS Entry Capacity at Milford Haven

EDF Energy welcomes this opportunity to respond to Ofgem's consultation on the proposed incentive arrangements for the provision of NTS entry capacity at Milford Haven. EDF Energy would like to offer the following comments.

EDF Energy welcomes any consultation which aims to expose NGG NTS to a higher proportion of buy back costs incurred at Milford Haven and to cap the industry's exposure to these unnecessary buy back costs. However, the need for this consultation has arisen because NGG NTS has sold entry capacity as part of the long term auctions, which may now not be ready in time for winter 2007 or indeed for early 2008. It would be useful for Ofgem to state whether it thinks NGG NTS has acted in an economic and efficient way in accordance with its licence condition.

Whilst EDF Energy is not supportive of measures which expose the industry to unnecessary buy back costs, we have endeavoured to provide answers to the questions in the consultation document.

Q.1 Should new incentive arrangements for National Grid Gas NTS (NGG NTS) be developed in relation to the delivery of gas transmission capacity at Milford Haven?

EDF Energy is of the view that it is appropriate for NGG NTS to be exposed to a higher amount of buy back costs in this situation. However, we are concerned about the level of costs the industry would be expected to pick up if the buy back exposure rose above £36m. We are also concerned about the wording in paragraph 4.18 of the consultation document which states that the £365.5m capital expenditure that NGG NTS has spent on Milford Haven is higher than it envisaged when Ofgem originally set the UCA. It goes on to state that the over recovery would be dealt with as part of the Transmission price control review. From our understanding, it seems that the industry will pick up not only additional buy back costs, but also the capital over spend. We also consider that failure of this gas to turn up on time could also have a significant Impact on the wholesale gas price. Therefore, EDF Energy is of the view that the Industry is facing a triple exposure because of NGG NTS's inability to reinforce its system in the time available.

Given the situation the industry finds itself in, EDF Energy does support a bespoke buy back arrangement at Milford Haven to ensure that NGG NTS picks up a higher proportion of the costs. However, we consider that if NGG NTS had been acting as a prudent system operator, this situation should never have arisen. If this situation has arisen due to failings in the auction or TBE processes, then this is certainly an area in which reform is needed.

Q.2 Are the principles identified in paragraph 4.3 an appropriate basis for the new incentive arrangements?

EDF Energy considers these assumptions to be an appropriate basis on which to design a buy back incentive scheme. EDF Energy considers that in this instance the first two bullet points are the most important for the bespoke buy back regime at Milford Haven. EDF Energy is of the view that the industry should not be obliged to pick up costs that have arisen due to NGG NTS being unable to deliver investment in a timely and cost effective manner.

Q.3 Should NGG NTS's exposure to buy back costs be deferred if there are undue delays due to consents for the construction of the reinforcement pipelines, adverse weather conditions or other exceptional factors?

Although EDF Energy considers that NGG NTS should pick up any unnecessary buy back costs, we do accept that, in exceptional circumstances that are beyond NGG NTS's control, its exposure should be limited. However, this would need to be done in a very transparent manner, both in consultation with the industry, and by Ofgem ensuring that there is a consensus as to whether a certain situation is deemed to be an exceptional circumstance.

Q.4 What are the advantages and disadvantages of the new incentive arrangements described in this chapter?

In theory it may be more appropriate to expose NGG NTS to a higher proportion of the costs earlier on in winter 2007 to incentivise it to reinforce the system in the quickest and most efficient time possible, but any option chosen must also expose NGG NTS to a higher proportion of costs in early 2008. Given that buy back costs are less likely to occur in the summer than the winter, EDF Energy is of the view that option B is the most appropriate option. EDF Energy considers that options B, C and D should contain a roll over option. That is, if NGG NTS spends only £2m in October, the remaining £2m should roll over to the next month and so on until NGG NTS delivers the capacity. EDF Energy also considers that if, for whatever reason, NGG NTS is unable to reinforce the system by October 2008, it should face the full exposure to any buy back costs encountered after this date.

EDF Energy notes that all the options limit NGG NTS's buy back exposure to £36m. We would like to understand why this is considered to be the appropriate cap.

Q.5 Should this deferral 'skip' the period November – February during which construction is not practical?

EDF Energy believes that only in exceptional circumstances should NGG NTS be able to default on its obligations and therefore have a limited exposure to its buy back costs. Thus, we believe that the period November to February should be included and NGG NTS should be exposed to buy back costs during this period. We accept that it would be impossible for NGG NTS to undertake reinforcement work throughout the whole of the November to February period.

Q.7 Are there further steps that should be taken to encourage NGG NTS and the relevant shippers to enter into arrangements that would minimise the economic costs of any delay in the provision of transmission capacity at Milford Haven

EDF Energy is concerned that, given that Milford Haven is an import terminal, it will be hard to prove that the LNG cargo was actually going to arrive. We therefore believe that Ofgem should explain how they intend to monitor this. With this in mind it may be more effective to remove NGG NTS's ability to smear the majority of its exposure onto system users, and instead to place an incentive on NGG NTS to enter into a bilateral agreement with the relevant shippers to ensure that any buy back payment is cost reflective. This will also have the effect of reducing the relevant shippers' ability to name their price.

We hope that you will find these comments helpful. If you have any queries please do not hesitate to contact me on 020 7752 2200 or John Costa on 020 7752 2522.

Yours sincerely

Denis Linford
Director of Regulation