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Dear Lewes

EDF Energy Response to "Reform of Interruption Arrangements on Gas Distribution Networks – An update" Ref 191/06.

EDF Energy welcomes the opportunity to respond to this consultation. Whilst recognising the intention of this reform, we continue to believe that it is inappropriate to implement radical reform of the NTS Exit regime at the same time as GDN Interruption reform. Both of these reforms will require GDNs to operate in an entirely new environment with no experience of how these regimes will work in practice. This could have serious implications for security of supply and the safety of the system.

We further note that one of Ofgem's concepts behind NTS Exit reform was that all exit points were equivalent and so should be treated equitably. Whilst EDF Energy does not believe that all sites are equivalent, we would note that Ofgem is proposing arrangements to ensure that GDNs are not exposed to excessive exit capacity charges, and is consulting on how these charges are recovered. We question whether Ofgem will be offering the same service to the NTS Exit points that are competing with GDNs, if they are equal. We would be interested in knowing how exit capacity charges will be capped and recovered for all Exit Points, and not just GDNs. It is clear from this consultation that GDNs are different from other NTS Exit Points and that NTS Exit reform is also unsound.

EDF Energy also believes that some of the assumptions behind Ofgem's impact assessment are inconsistent. We note that discussions in the development workgroup focused around the fact that the majority of interruptible sites remained interruptible, not because of the cost savings, but because of a lack of momentum. Many participants noted that these reforms would force interruptible consumers to reassess their position and the majority of these would not be prepared to offer interruptible services. This could have a serious impact on the investment required, especially for Network Sensitive Loads (NSLs) that chose to go firm, yet these costs do not appear to have been included in the NPV test. We would therefore request that a full Impact Assessment consultation is undertaken, that includes investment costs and the HSE's views and impacts that this reform may have.

We also question the assumption that the current regime provides excessive quantities of interruption, solely on the basis that GDNs believe they can accommodate the few sites that request to go firm and the low levels of interruption required since 1996. Since 1996 there has not been a single 1 in 20 winter – in fact the weather has been mild. It is

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therefore not surprising that interruption volumes have been low given that these would be required to maintain a system in a 1 in 20 winter.

Please find attached our responses to specific questions in appendix 1.

If you have any queries on this response, please contact Stefan Leedham on 020 7752 2145 or myself.

Yours sincerely

Denis Linford
Director of Regulation

Appendix 1

Chapter 3

Q1: Which of the options proposed by Ofgem for setting a one year incentive for the GDNs purchases of interruptions and NTS Offtake Capacity do respondents support and why?

One of the issues with these incentives is that they need to be set for operation in 2007, although no costs or revenues will be experienced until 2010, and the purchases could be out to 2013 for NTS Exit Capacity and 2015 for DN Interruption. It is clear therefore that whilst Ofgem will be setting a one year incentive its impacts could be felt for the next two price controls. Options 1 and 2 provide an incentive that bears no resemblance to the costs other NTS Exit Points will be faced with due to the use of caps, collars and sharing factors. If Ofgem believes that all NTS Exit Points are equivalent, then Option 3 is the only incentive that can be set as it bears the closest resemblance to the competitive market that all the other NTS Exit Points operate in.

Q2: What are respondents' views on the factors that should determine the level at which interruption and NTS Exit Capacity incentives are set?

In relation to the NTS Exit Capacity incentive, then the overriding factor should be the arrangements that are in place for the other NTS Exit Points. Given that there, apparently, is no difference between an NTS/LDZ Offtake and a directly connected power station, it would appear similar factors can apply. It would therefore appear that GDNs should only be allowed to recover the costs that are efficiently occurred, and be open for any over or under run of costs. The efficient cost of this could be identified from either the lowest price paid for the products in the market, or the lowest price paid for the products by a GDN.

With regards to GDNs' exposure to the market power of NSLs', we would concur with Ofgem's view that the Competition Act 1989 would provide sufficient protection against NSLs abusing their market power. In these instances it is likely that NSLs will provide an interruption service based on their incurred costs and GDNs will be able to reach a simple economic decision as to whether to invest or not. In these circumstances only the GDNs will be able to manage the risks involved and it would appear inconsistent for Ofgem to share these risks with customers who have no ability to manage or minimise these risks. If there is a risk that the costs will be excessive then this may indicate a flaw with the reform proposals and they should therefore not be progressed.

Q3: Do respondents agree with Ofgem's proposal to set a one year incentive for GDN's purchases of interruption and NTS offtake capacity from October 2010 and longer term incentives as part of the GDPCR?

As previously stated whilst this may be a one year incentive, the implications of this incentive will be felt for the next two Gas Distribution Price Control (GDPC) periods. It may therefore be better to set incentives for the period in which the purchases will operate, with the ability to review at each GDPCR. This should provide more certainty and transparency for the GDNs who will be impacted by these incentives.

Chapter 4

Q1: Do interested parties agree with the estimate of the costs of implementing GDN interruption reform?

We are disappointed to see that Ofgem has arbitrarily altered the costs behind the impact assessment even though they have not reviewed these in detail, and with little explanation as to the basis of these alterations. We would also note

- There are only 7 industrial and commercial shippers impacted by this reform.
- That in the absence of cost estimates from customers, the costs quoted by Ofgem are under estimated.
- That the Impact Assessment has failed to include the potential, and likely, investment costs associated with this reform.

EDF Energy believes that it is vital for an accurate NPV test to be conducted that all the likely costs are included, especially investment costs.

Q2: Do interested parties agree that Ofgem has identified the appropriate benefits of reform of the GDN interruption arrangements?

At this stage, without having a proposed pricing methodology, it is very hard to identify whether Ofgem's benefits will be realised or not. Better investment signals require sites to identify the true cost/value of interruption this can only be done through an open tender process. It is not clear whether this option will be implemented. This benefit also relies on the assumption that the complexity of these arrangements will not prevent consumers from participating in this tender process. The development workgroup report highlighted the fact that under these arrangements it was more likely that the UK would progress quickly from Stage 1 to Stage 3 of an emergency, and that as sites were less prepared to be interrupted, potentially Stage 4. We would question how this would be beneficial to security of supply. It is also clear from the development work group that the number of consumers prepared to enter into this process will significantly decrease, it is therefore not clear that comparative regulation between GDNs will be possible, as they may be forced to accept whatever interruption is available on their network. It therefore appears that whilst the costs have been understated, the benefits have been overstated.

Q3: Do interested parties agree with Ofgem's estimate of the range of potential quantitative benefits of GDN Interruptions reform?

The benefits identified by Ofgem appear arbitrary with little evidence behind them. We believe that the reason for these vagaries is that reform has been based on an economic theory that may not reflect actual operational practices, and so there are no easily identifiable benefits from implementation of this regime. However given that one scenario is that no investment was required, an alternate would be that investment was required to make all interruptible sites firm. Both are at opposite ends of the spectrum and so inclusion of one requires inclusion of the alternate to ensure the full spectrum of outcomes is incorporated in the impact assessment. EDF Energy would also request evidence supporting the two efficiency figures, based on the actual results of GDN sales. We recognise that there is not a significant amount of information following these sales, however we would expect some evidence to demonstrate whether Ofgem's original assumptions were correct or not. We believe that this would identify whether these efficiency assumptions are reasonable or not, and so inform the impact assessment. Until these are forthcoming then the quantitative benefits appear arbitrary with little evidence of their accuracy.

Chapter 5

Q1: Do interested parties have any views about the timing of the introduction of the new arrangements for the customer charge?

EDF Energy responded to the pricing consultation paper on this issue. We continue to be unable to support this proposal due to the short lead times involved, and the system implications required to support it. Due to the numerous dispensations required to implement this proposal on 1 April 2007, we would request that implementation is delayed until 1 October 2007 at the earliest.

Q2: Do the benefits outweigh the costs associated with changing the timing of changes to gas distribution charges from October to April each year to align with changes in allowed revenue?

It appears inefficient for gas distribution charge changes not to be aligned with changes in allowed revenue. This creates instability and volatility in these charges from year to year. It would therefore appear more efficient for charge setting purposes to align these two periods. However in order to introduce these arrangements we would request adequate lead time to ensure that the required systems are in place, and that contracts are altered to reflect this reform. We therefore do not believe that 1 April 2007 is a feasible implementation date, as the costs associated with implementing this reform in such a short time frame would considerably exceed the benefits of such a reform. This reform would also have a commercial impact on suppliers who had entered into 12 month contracts based on the prevailing charges in October 2006, only to be faced with an unexpected and unrecoverable change. It is imperative that the industry is provided with adequate lead time to ensure these issues are resolved prior to these new arrangements being implemented.