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Ofgem
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06 March 2007

Dear Mark

EDF Energy Response to Consultation 23/07 “National Grid Gas – Offtake Arrangements Final Impact Assessment on modification proposals.”

EDF Energy welcomes the opportunity to respond to this consultation; however we continue to believe that NTS Offtake Reform is not warranted at the level Ofgem is proposing and that the current arrangements operate efficiently. We therefore believe that modification proposal 0116A should be implemented. In order of preference we would rank the modifications as: 0116A (most preferable), 0116CVV, 0116BV, 0116VD, 0116V (worst proposal).

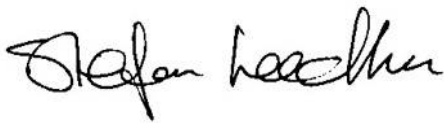
We further welcome the work that Ofgem has done in conducting an impact assessment in order to aid the Authority’s decision. However we note that not all of the recommendations contained within the National Audit Office’s (NAO’s) report and the House of Commons Public Accounts Committee (HoCPAC) report into DN Sales and future impact assessments have been incorporated into this assessment. In particular we would have hoped that a probability outcome would have been attached to the NPV analysis for each modification, and the elements that formed it. We would also have hoped to have seen a stronger recommendation for the proposal that delivers the greatest benefits to consumers, rather than focusing on the qualitative issues, which by their very nature cannot be assessed as readily as quantitative ones.

EDF Energy is further concerned that adequate analysis of the impacts on the electricity system has not been undertaken and so have not formed part of the impact assessment, or the knock on environmental impacts that this regime may have. We would note that implementation of a flexibility regime that discourages gas generators from producing at peak times during the day could have an adverse impact on the electricity system’s security and encourage the use of more carbon intensive generation to meet this peak demand. Both of these will represent a cost to consumers, yet neither appears to have made it in to the impact assessment. It is also worth noting that Ofgem are currently looking to simplify the complex mechanisms in electricity. We believe it would be helpful if the interaction between the two regimes was fully analysed and the impact on industry parties and costs minimised. While Ofgem has always performed this sense check in the past it is apparent that this piece of work has not been undertaken and we urge Ofgem to evaluate the impact and interaction with Electricity and Transmission access reform as a “lessons learnt” exercise and apply the principles of better regulation.

EDF Energy continues to believe that implementation of any proposal other than 116A or 116CVV will have a negative impact on the gas system, the gas industry and gas consumers in general. We believe that the other proposals will be detrimental to demand side response. It will discriminate against Users who have storage capacity and reduce the required flexibility that these sites can provide to the system. It will increase costs to both gas shippers and gas consumers for a perceived marginal benefit that should already be protected through the Competition Act.

We hope you find these comments useful, and please see the attached appendix for our detailed answers to the questions asked. If you have any questions please contact either myself (0207 752 2145) or my colleague John Costa (0207 752 2522).

Yours sincerely

A handwritten signature in black ink that reads "Stefan Leedham".

Stefan Leedham
Gas Market Analyst
Energy Regulation, Energy Branch

Appendix I

Chapter 2

Do you have any comments on the process associated with the modification proposals that have been raised?

While EDF Energy believes that the proposals have undergone adequate processes, including significant development work through the Enduring Offtake Working Group (EOWG) in relation to modification proposal 116V, we would note that this does not automatically make a modification proposal a good proposal or not. Whilst we welcome the work that Ofgem undertook in facilitating the EOWG, we would note the effect of this was to improve the original proposal, but that the outcome in 116V still represents a bad solution (albeit an improvement to the original proposal).

We are further disappointed to note that the panel recommendation or industry's support or opposition in relation to the proposals is not present in this section of the IA. While we recognise that these recommendations will be available to the authority we feel it should have been included in this section to provide a full background. We would note that this information would have shown unanimous opposition to modification proposal 116V, but would have provided a useful background and informed responses.

Chapter 3

We would welcome views of the analysis presented in this chapter.

Whilst we recognise that the measurable costs associated with this reform are in contrast to the less measurable benefits, EDF Energy is disappointed to see that the full recommendations of the NAO Report and HoCPAC report into DN Sales has not been incorporated into this IA. Central to these reports was the recommendation that Ofgem incorporate a probability analysis into the IA to inform the Authority of the probability of achieving the full Net Present Value (NPV) associated with each proposal. Given the uncertainty associated with these proposals we feel that this would have provided essential information to the Authority when reaching their decision.

EDF Energy is also concerned that an additional finding of both the NAO and HoCPAC report was that the Authorities role should be to secure the maximum value for consumers, and so implement reform that provides the greatest benefit. Given these duties we are therefore concerned that Ofgem has failed to give its clear backing to the proposal that can clearly be seen to secure the greatest NPV for customers – 116CVV. In relation to the particular cost benefits identified by Ofgem in this IA, we would make the following comments:

- **Efficient Investment Signals.** EDF Energy fully supports the findings of NERA, as commissioned by the Gas Forum. We believe that the use of a 6.25% capex efficiency rate is subjective, and the use of a capex benefit of £22.3m or less is more appropriate.
- We believe that the risk identified by Ofgem that loads will trigger significant investment on the NTS and then subsequently be mothballed, in relation to new build plant is minimal and insignificant. Given the capital intensity of new plants that wish to connect to the NTS, we consider it highly unlikely that companies would undertake hundreds of millions of pounds of investment in new plant and then decide to mothball them, especially given the likely generation gap in the next 10 to 15 years, highlighted by the Energy Policy Review.
- **Non-discriminatory allocation of capacity products.** EDF Energy considers that Section 9 of the Gas Act, National Grid Gas' licence conditions, and the Competition Act should provide sufficient protection to ensure that National Grid Gas is not favouring its

retained Distribution Businesses when allocating capacity. We believe that if Ofgem has evidence that NGG is breaching any of these, then enforcement action should be taken against NGG. However in the absence of such evidence it is hard to justify the benefits that could be achieved.

- **Reduced Incidence of ARCAs.** EDF Energy fully supports NERA's findings for the Gas Forum in relation to the benefits from the reduced incidence of ARCAs. We believe that the reforms could have the unintended effect of introducing new and different types of disputes and that the complexity of the regime would increase the costs of scrutinising NGG's decisions. We therefore believe that a net benefit in the region of £0 to £5m would be appropriate compared to the transitional arrangements.
- **Shipper Costs.** We note that to date NGG report that the peak aggregate use of flexibility has been up to 15mcm/day, compared to the proposed release of 22mcm/day. We believe that this clearly demonstrates how the release of a seasonal product on an annual basis with no effective UIOLI arrangements will create an artificial constraint and potentially increasing prices.
- We are further concerned to see that Ofgem considers the costs submitted by Shippers as excessive and an overstatement of true costs with little in the way of substantive evidence to back this up. By the same token the benefits identified by Ofgem could be viewed as excessive and an overstatement of the true benefits, especially as these benefits are harder to identify and quantify than the costs.
- Whilst we recognise that developments through the EOWG resulted in flexibility being available through bookings, unless there was a constraint, we find it disingenuous that Ofgem believe that this removes the requirement for Shippers to maintain the ability to purchase capacity through an auction should there be a constraint. We would note that without this ability Shippers would be limited to running flat on a constrained day, which may not be feasible, or risk incurring significant overrun charges. We would note that this in itself could be viewed as a barrier to entry to smaller Shippers who may not be able to fund the resources required for this function, or may not have the experience in dealing with complex auctions.
- **Costs to Transmission Connected Customers and Storage Sites.** We are concerned by Ofgem's belief that Transmission Connected Customers (TCCs) will not need to incur staffing and operational costs as the primary interface between NGG and TCCs will be the Shipper. We note that one of Ofgem's principles behind exit reform was that TCCs and GDNs were better able to forecast their capacity requirements than NGG. It therefore appears inconsistent to assume that Shippers will be able to forecast the TCCs' requirements any better than NGG, especially when a Shippers' relationship is normally limited to a one year period. EDF Energy therefore believes it is reasonable to expect TCCs to incur staffing and operational costs as they attempt to predict their capacity requirements 3 years out, and instruct Shippers to book it on their behalf.
- **Cost to Gas Transporters and their Agency.** While we recognise Ofgem's point that the cost of exit reform should be incorporated into the independent GDNs' purchasing price, we would question how this would have been feasible with no firm view of what any proposed exit reform would look like. We would note Ofgem's current difficulties in setting a Capacity Output Incentive for GDNs in the 2008-13 Gas Distribution Price Control Review (GDPCR) without a clear indication of what exit regime will be operational at the time, despite the firm proposals that are currently on the table. Given these difficulties we find it unfathomable that the GDN purchasers would have been able to adequately reflect the cost of interruption reform into their purchase prices.

Chapter 4

We would welcome views on issues raised in the chapter.

EDF Energy is disappointed to see Ofgem placing an excessive amount of weight on the qualitative benefits of NTS Exit Reform. Whilst we recognise that with any reform there will be

costs and benefits that are hard to identify and quantify, we do not believe that their impact should be focused on too heavily. We believe it is appropriate to identify and note any additional potential benefits, but as there is a risk that these perceived benefits will not be achieved they should only be used to inform decisions when the choices are evenly matched. In this instance it is clear that modification proposal 116CVV has far greater benefits associated to it than the others, and so the qualitative benefits whilst of interest should not form a central part of any decision. In relation to the points raised in the IA we would make the following observations:

- **Efficient network development and system operation.** EDF Energy notes Ofgem’s belief that by auctioning flexibility and short term flat capacity those that value it most should receive it. However we would also note NGG’s comment that historically only 15mcm/day of flexibility has been required, compared to the 22mcm/day due to be made available. We believe that these two comments appear to suggest that flexibility capacity will be artificially constrained and place a value on a product that should be abundant and provided at zero cost.
- It would also appear that whilst economic theory dictates that those who are the most economic and efficient will be able to outbid others in an auction, and so ensure the most efficient utilisation of scarce resources, this only works in a truly competitive market with clear competitors. However in the case of NTS Exit Reform there are several different classes of customers who are not natural competitors, with some operating in a competitive market and some acting as natural monopolies. To force competition on these different classes of consumers will only ensure those with the deepest pockets with a guaranteed income stream will be able to purchase the products, leaving those less able to compete in such a market short.
- EDF Energy therefore disagrees that the qualitative benefits of efficient network development and system operation would be maximised by modification proposal 116V. It would appear that these benefits could in fact be viewed as costs, especially as mods 116V; 116BV and 116VD attempt to create competition between different classes of customers that would ultimately favour the regulated monopoly. By not introducing these costs 116A appears the most efficient, whilst 116CVV minimises the costs by only creating artificial competition on short term flat capacity and not flexibility.
- **Promotion of competition.** EDF Energy agrees with Ofgem that the additional complexities and transactional costs associated with the implementation of the “proposed enduring regime” (116V, 116BV and 116VD) could impact on the shipping sector to the extent that they create barriers to entry which would be detrimental to competition. Given that the Shipping community is the only competitive party to the UNC we consider this a serious threat to the competitive market and consumers. We therefore believe that 116A will overcome this issue, and 116CVV will minimise this by only creating complexity and costs on one offtake product that is easier to identify and predict. As previously noted EDF Energy is aware that Ofgem is looking to simplify the requirements in electricity, whilst looking to impose additional complexity on the gas market. We believe that this is inconsistent with the core principles of better regulation, and a full analysis should be undertaken to ensure that these proposals comply with this concept.
- **Simplicity and Transparency.** We again agree with Ofgem that modification proposals 116CVV, 116BV, 116VD and 116V will increase complexity and reduce transparency with 116V being the most complex and least transparent and 116CVV being the least complex and most transparent. We recognise that this is an improvement on the original proposals, but this is not an improvement on the current arrangements. Given that these proposals will be based on their improvement over the current market arrangements we do not consider that this will represent a saving for consumers, but a cost, albeit less of a cost than the original proposals.
- **Ensuring security of supply.** While we recognise that User commitments may provide greater clarity with regards to future offtake requirements, and this would potentially be

beneficial to gas security of supply, we are concerned that the impacts on storage have not been adequately analysed. EDF Energy is of the opinion that storage is used as a means of balancing within day demand. For domestic suppliers this demand is dependent on the forecasts produced at the day ahead and within day stage. As these forecasts change Shippers vary their storage injection and withdrawal nominations to ensure that their supply is balanced. By potentially constraining storage injections through flexibility there is a risk that Shippers will be unable to balance, or will choose to be out of balance and avoid high overrun charges. This would be detrimental to security of supply.

- EDF Energy is further concerned that the impact on the security of supply for the electricity system has also not been considered. Again by artificially constraining CCGTs through flexibility these sites will not be able to provide flexibility to the electricity system if required.
- **Preventing Undue Discrimination.** EDF Energy believes that Section 9 of the Gas Act, National Grid's Transporter Licence and the Competition Act should provide adequate protection against the threat of undue discrimination by National Grid. If Ofgem has evidence that these are not providing adequate protection then we would question why enforcement action has not been taken.
- EDF Energy is concerned with Ofgem's view that GDNs and Shippers are not materially different classes of customers. Whilst both will place a cost on NGG by using the pipeline, and costs should be recovered from each proportionate to the costs that are imposed, we would note that this is not the effect of modification proposals 116V, 116BV or 116VD. The effect of these modifications is to artificially create competition between classes of Users that are not natural competitors. Whilst one operates in a competitive market the other is a natural monopoly with regulated revenues and thus a certain amount of protection exposure. They are exposed to different levels of risk and have different abilities to absorb costs and fund purchases. It appears intrinsic that these classes of Users are materially different and so should not be forced to compete.
- **Health and safety.** EDF Energy is of the opinion that by removing Transporter Nominated Interruptibles (TNIs) from the system then modification proposals 116V, 116BV, 116CVV and 116VD will have a material impact on the safety case. It will therefore be up to the HSE to approve or reject the changes, and decide whether the impact on health and safety will be positive or negative.
- **Impact on Other Markets.** The complexity of the UK regime compared to the Continent will leave the UK at a disadvantage compared to our counterparts on the continental markets. Therefore prices in the UK are likely to increase as a result of the artificial constraints Ofgem is placing on the UK market which can only cause UK prices to increase compared to continental prices. EDF Energy does not believe that this is in the best interests of the UK consumer.