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Dear Richard

EDF Energy Response to Ofgem's Review of Entry Capacity Operational Buy-back Incentive and Default Incremental Entry Capacity Lead Time

EDF Energy welcomes the opportunity to respond to this consultation

As a general principle EDF Energy does not support Price Control reopeners unless they have been identified and programmed in at the start of the review. We welcome therefore Ofgem's foresight in programming a window into the 2007 Transmission Price Control 4 (TPCR4) to review NGG's buy-back incentive parameters after 2 years given the uncertainty with forecasting costs.

We agree that the drivers and market conditions have changed significantly in the last two years when TPCR4 was set for the period 2007 to 2012. We believe that National Grid Gas' (NGG's) risk reward balance has changed significantly in the last few years following the creation of extra Transmission capacity facilitating flows across the UK. This coupled with decreasing demand and supplies from UK Continental Shelf mean that NGG are less likely to undertake the level of capacity buy-backs that were envisaged at the time TPCR4 was designed. This is potentially reflected in the fact that NGG has consistently outperformed on its entry capacity operation back-back performance every year since 2002 bar one year - 2006/07 - which was an exceptional year due to the mistiming of capacity build to accommodate extra Norwegian flows at the Easington terminal.

We have answered Ofgem's questions individually in the annex below and I hope you find these comments useful, however please contact my colleague John Costa (john.costa@edfenergy.com , 0203 126 2324)

Yours sincerely

Dr. Sebastian Eyre
Energy Regulation, Energy Branch

Question 1: Do you agree with the assessment we have set out for Option 1 - changing the cap and collar of the incentive?

We agree with Ofgem that that changing the cap and collar would not make any difference or address the changing drivers at hand given that NGG has not reached the extremes of the performance measure over the last 6 years.

Question 2: Do you have any views on lowering the incentive collar to better protect consumers?

See answer above - lowering the incentive collar could better protect consumers however there is no evidence that NGG's behaviour will change given their history of out performance. It is the performance measure and target that need adjusting to reflect the lower buy-back risk.

Question 3: Do you agree with the assessment we have set out for Option 2 - changing the sharing factor of the incentive?

We believe that changing the target would be the best way to sharpen the incentive and therefore agree that changing the sharing factors is not necessary.

Question 4: Do you agree with our analysis of NGG's historic performance regarding the incentive?

We agree with how Ofgem has done their analysis however find it difficult to validate the figures. However, we note that the level of buy-backs in 2006/07 were related to a single event relating to Easington capacity not being available to support new pipeline to Norway and therefore this level of risk for NGG is unlikely to be repeated.

Question 5: Do you agree with the analysis of the estimated future buy-back risk? Specifically, do you agree with NGG's application of a lognormal assumption for the distribution of buy-back costs? Do you agree with the use of historic buy-back prices in estimating future buy-back risk?

We agree with Ofgem that NGG should not use the extreme buy-back prices witnessed in 2006 as these were a one off as explained. We believe that buy-back costs are directly correlated to gas prices and therefore a rolling average of the last 6 years back to 2002 could be used which would take into account an extra year's worth of data in 2008. We also believe that other factors such as lower demand and UKCS suppliers (2008 10YS shows a 10% reduction on 2005) coupled with lower compressor usage following new environmental incentives should be taken into account in calculating NGG's level of risk.

Question 6: Do you consider it appropriate to use the analysis done at the baseline review as part of forming our decision on reviewing the entry capacity operational buy-back incentive?

Yes, however we would expect Ofgem to take in into account all the information and data available as mentioned above in our response to Question 5 as the UK, and world gas markets, have changed significantly in the last 12 months since NGG did its analysis as part of the Baseline Review.

Question 7: Do you agree with our view that an entry capacity operational buy-back incentive target of £13 million per year will still provide NGG with sufficient incentives to contain the costs of buy-back?

Yes, however, given the information we have provided above to questions 5 & 6 relating to changing gas markets and risk we believe that an operational buy-back incentive of £13m may now represent a high/ worst case scenario.

Question 8: Do you consider that a £13 million entry capacity operational buy-back incentive target is appropriate given NGG's return on equity performance?

Yes, as it only reduces NGG's overall real post-tax return on equity by 0.14%.

Question 9: Do you agree with our provisional view to reduce the target level of the entry capacity operational buy-back incentive to £13 million per year?

Yes, as per our answers to the above questions. However, £13m may actually be too high given that recent (2008) UK gas fundamental data and prices have not been taken into account.

Question 10: Do you agree with the assessment we have set out for Option 4 - doing nothing and keeping the incentive in its current form?

No, as it is apparent the NGG's risk reward balance has changed and this is why the review after two years was pre-programmed into TPCR4.

Question 11: Do you agree with our proposed approach of retrospectively modifying NGG's gas transporter licence by implementing the proposed changes to the entry capacity operational buy-back incentive parameters as of 1 April 2009?

Yes.

Chapter four - Review of default incremental entry capacity lead times

Question 1: Do you agree with our proposal to defer the review of the default incremental entry capacity lead times until the next transmission price control review?

Yes. NGG's default entry capacity build lead times were originally 36 months and were then, after a request from NGG, increased to 42 months to reduce its risk with brining on Entry capacity on time following planning constraints, even though NGG can make Exit capacity available under the 36 month lead time.

We remain unconvinced of the need to add another 6 months to their lead times at the current time and believe that this would adversely affect the current NTS projects that are in the pipeline. We also note that NGG has cards that it can play to bring on investment earlier or delay it without incurring any financial penalties and therefore do not see the need for further measures at this stage.

Question 2: Are there any other considerations which we have not highlighted which we should have taken into account?

We also not e that NGG has raised UNC modification 230 to delay the QSEC auctions this year by 18 months so that they can start in April with an October delivery time. Increasing their time line to 48 months would conflict with NGG's desire to have their UNC modification 230 implemented as it would mean that it would revert to having to make capacity available in the summer months even though most projects come on line in October each year in line with the contractual Gas year.