

Bogdan Kowalewicz
Senior Manager, Gas Transmission Policy
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

4 June 2010

Dear Bogdan,

**Proposed disposal of part of NTS for Carbon Capture and Storage
Second consultation and initial impact assessment**

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, renewables, coal and gas-fired electricity generation, combined heat and power plants, electricity networks and energy supply to end users. We have over 5 million electricity and gas customer accounts in the UK, including both residential and business users.

EDF Energy believes that all technologies will be needed to deliver the transition to a low carbon economy and that Carbon Capture and Storage (CCS) provides an opportunity to retain coal and gas within the generation mix, while minimising the impact of climate change. Therefore, we see the merit in supporting demonstration CCS projects as a first step in CCS deployment and preparing the regulatory framework for CCS deployment. However, it is important to set clear limits on the level and duration of support for CCS demonstration, taking account of realistic targets of project delivery and the need to minimise the total costs of the subsidy to the consumer. Additionally, we believe that any regime should ensure that there are no cross subsidies between CCS and gas transportation, for example through an asset sale.

In the context of minimising costs, we see the benefit in the principle of re-using existing assets if they can be put to better and more efficient use elsewhere if this is in the interests of both industry and consumers alike. However, following successful demonstration of CCS, the pace of implementation of CCS across fossil-fuel generation should be determined by the delivery of the UK carbon budgets and driven by the carbon price.

We take reassurance from the fact that independent consultants have verified the conclusion of the original National Grid Gas (NGG) analysis stating that there would be minimal likelihood of the proposed asset disposal resulting in any adverse impact on the gas system. We believe that the revised National Grid proposal represents a good deal for consumers as they are protected from the downside risk while being able to benefit from any upside potential as a result of the success of CCS as a viable commercial technology. We would also reiterate our support for the proposal that NG Carbon should bear any incremental buyback and opex costs resulting from the removal of the feeder and that gas shippers and consumers should not be exposed to these. However, we seek clarity on whether the value of the disposed assets will be removed from NGG's Regulated Asset Value (RAV) as we believe that NGG should no longer be making a return on assets that are no longer in its control, even if the existing baselines are retained following a disposal.

Our detailed response to the consultation is set out in the attachment to this letter.

Should you wish to discuss any of the issues raised in our response or have any queries please contact my colleague Stefan Leedham on 020 3126 2312, or myself.

Yours sincerely,

A handwritten signature in black ink, appearing to read "D. Linford".

Denis Linford
Corporate Policy and Regulation Director

Attachment

Proposed disposal of part of NTS for Carbon Capture and Storage Second consultation and initial impact assessment

EDF Energy response to your questions

CHAPTER 4: Future flows at St. Fergus and pipeline capability

Q1. What is your view of the conclusions drawn about future flows and capability based on the consultants' reports?

We cannot comment on whether NGG's analysis of capability and future flows is accurate and therefore we welcome the independent authentication that was carried out by consultants to validate these results and provide an assurance on the robustness of the original NGG analysis.

We note from Wood Mackenzie's analysis that it forecasts a peak maximum demand flow of 128 mcm/d by 2015, with a gradual decline to around 105 mcm/d by 2018. We are therefore able to draw comfort that this is well within the proposed capacity at St. Fergus, and that the analysis is able to support NGG's conclusion that the proposed disposal would not have an adverse impact on system capacity, even allowing for some potential upside from additional West of Shetland and Norwegian flows.

Similarly, we welcome Pöyry's general validation of NGG's modelling and its view that NGG has probably overstated the impact of removing the feeder from the NTS. This approach provides us with reassurance that the impact on network capability of the proposed disposal has not been underestimated.

CHAPTER 5: NGG's revised proposals

Q1. What is your view of the structure of the revised proposal overall?

EDF Energy supports the introduction of a regulatory regime to enable CCS deployment but believes that any regime and asset sale should ensure that there are no cross subsidies between CCS and gas transportation. We believe that any arrangements should ensure that Gas Shippers and consumers are not exposed to increased System Operator costs in the long run and that an appropriate value is attributed to the assets which are then removed from NGG's RAV. We would, therefore, seek confirmation that it is in fact the case that the value of the disposed assets will be taken out of NGG's RAV, as Paragraph 5.7 states that NGG's 'allowed revenues are unaffected'. It is our belief that National Grid should no longer be making a return on assets that are no longer in its control, even if the existing baselines are kept following a disposal.

We support NGG's proposal to retain the current baseline levels at St. Fergus as this will provide ongoing certainty to Gas Shippers in their operations and limit the impact of regulatory risk. EDF Energy believes that this will ensure that the UK's security of supply is maintained and that the UK remains an attractive destination for imported gas and investment.

Q2. What is your view of the treatment of incremental buyback, opex, CFU and other costs identified?

EDF Energy supports the assertion that consumers should not be subject to an increase in buyback or opex costs, and that any incremental costs/risks resulting from the removal of the feeder should unequivocally be borne by NG Carbon. We believe that Ofgem should consider the merits of conducting an independent audit to verify any potential increases in costs, and that a methodology to cover these potential costs is clearly established.

EDF Energy would also support the development of a methodology to identify how buyback or opex costs are treated. In particular, we would seek clarity on how Ofgem and the industry would be able to ascertain whether a buyback cost or incremental opex costs had been incurred as a result of general NTS operational issues or as the result of disposal of part of the NTS. Without this transparency there is a risk that Gas Shippers (and hence consumers) will have to fund all, or an excessive proportion, of these costs as their source cannot be clearly identified.

Q3. What is your view of the suggested approaches to asset valuation?

We believe, as a general rule, that assets should be valued in a competitive open market process that leads to price discovery based on the supply and demand balance. We note that, in the case at hand, there appears to be a lack of alternative interested parties. However, we believe that, in order to be consistent with a principle of transparency and fairness, that Ofgem should invite non-binding expressions of interest for the potential sale of the assets on the open market as this will help determine the value of the assets in alternative uses. This principle should also underlie future asset disposals in order to promote consistency. Furthermore, given that there are few definite timescales set in the DECC CCS competition, it is not necessarily the case that this process will lead to a delay in the trial.

Q4. What is your view of the proposal for sharing the benefits of increased CO₂ throughput?

EDF Energy believes that the proposal for sharing the benefits of increased CO₂ throughput represents good value for gas consumers in the event that CCS is a success, being exposed to no downside risk, while still benefiting from an upside potential. The sharing factors proposed seem adequate enough to provide sufficient incentive to NG Carbon to increase the volume of CO₂ transported. Such an arrangement will benefit both NG Carbon and gas consumers alike. We understand the rationale of capping the benefit if flows exceed a certain level. However, since it is NGG's assertion that significant additional investment will

be required to increase capacity beyond this point (i.e. 6Mt/yr of CO₂), we believe that Ofgem should consider carrying out an independent assessment of the cost of additional compression in increasing the capacity beyond this baseline to verify this assumption.

Q5. What is view of the suggested mechanism for returning value to gas consumers?

EDF Energy supports NGG's proposals for the payment of monies to gas consumers, namely that the disposal value is payable by NG Carbon in the year following disposal. However, we are unclear why the 'dividends' should be payable over a five year period rather than in a single year. Although there will be a benefit from the reduced volatility of network charges, Gas Shippers in general (including EDF Energy), have noted in the past that it is not the volatility of charges that causes an issue to Gas Shippers, but their ability to forecast these charges. As such, recent changes to the transportation methodologies that seek to reduce volatility have mainly been driven by the fact that they are seeking to reduce the volatility that Gas Shippers are unable to forecast and model themselves. As the dividend payment will be transparent, Gas Shippers will be able to model this. We therefore do not believe that returning these dividends to consumers in one year, as opposed to being spread over five years will add, or detract from the volatility in charges that are already present. There is, however, an argument that this dividend should be returned to consumers over one year, as it allows them to realise the benefit from the disposal of these assets in a shorter timeframe than if they were returned over a five year period.

In addition, we are unclear why the buyback and opex sharing costs should be spread over five years, with any deficit used to offset any surplus in future years. We would note that the gas buyback and SO incentives are essentially yearly incentives, targeted at the year in which they are incurred. Therefore, if NGG's buyback costs are below target in a specific year, then these revenues are refunded to consumers in that year based on the sharing factors within the incentive. The proposal to use deficits in one year to fund surpluses in following years breaks from this principle by essentially setting a five year incentive. We are unclear why NGG is proposing to break from this principle with regards to this disposal.

Q6. Are there any other considerations which have not been taken into account?

EDF Energy is unclear whether this disposal would also require a re-evaluation of NGG's Shrinkage and Emissions incentive and funding arrangements. In particular, we would note that NGG has been granted an incentive based on a volume of gas that will be required for shrinkage that includes compressor operation. This has been based on the compressor requirements of the NTS as it currently stands. Removal of these assets and the associated compressors from NGG's ownership will therefore reduce these shrinkage costs. It would appear appropriate that these targets and incentives are reviewed to ensure that NGG does not inadvertently gain under the shrinkage incentive as a result of this disposal. We would also note that the Emissions incentive has also been based on a volume of gas that will be vented to the environment in an attempt to ensure that NGG is exposed to the costs of this to the environment, and so incentivise it to reduce these emissions. Again, EDF Energy

believes that NGG should not benefit under this incentive as a result of the disposal of these assets and so it would appear appropriate to review this incentive.

Appendix 2: Initial Impact Assessment

Q1. Do you agree with our initial assessment of the impacts of the proposal for the disposal of assets?

We agree with the scope of the quantitative and qualitative factors that have been assessed and the corresponding impacts.

Q2. Are there any quantitative benefits or costs that have not been included in our assessment?

We believe that the key quantitative benefits and costs have been covered in the assessment.

Q3. Are there any qualitative benefits or costs that have not been included in our assessment?

We believe that the key qualitative benefits and costs have been covered in the assessment.

Q4. Are there any other considerations that have not been included in our assessment?

We believe that all material considerations have been included in the assessment.

EDF Energy
June 2010