

Jan Gascoigne
Regulatory Frameworks
National Grid House
Gallows Hill
Warwick
CV34 6DA



05 June 2007

Dear Jan

EDF Energy Response to GCM06 “Further Revision to Obligated NTS Entry Capacity Reserve Price Determination”.

EDF Energy welcomes the opportunity to respond to this consultation and offer comments on the specific questions asked, which are provided in the appendix to this letter.

We are however disappointed that despite going out to consultation on the inclusion of spare capacity in the past and having unanimous support from the industry to exclude spare capacity this issue has to be revisited following Ofgem’s decision letter on GCM01. We recognise that NGG’s position on this issue is being forced by the regulator’s desire to revisit the issue, who ultimately also hold NGG’s purse strings; however we remain concerned that theoretical concepts are being pursued with little or no firm evidence to support this work, and with no clear identification as to exactly what concept is being pursued.

We are also concerned with the significant amount of reforms that are being pursued at the same time with regards to entry capacity, creating significant regulatory and financial risk for both the Transporter and Shippers. Paramount to this issue is the recent revision to baselines enacted as part of the Transmission Price Control Review (TPCR), which has materially adjusted the amount of obligated capacity available at certain entry points. Given that the physical nature of the NTS has not altered significantly when setting this capacity, it would appear that Ofgem has in fact removed spare capacity from certain entry points and potentially sterilised it. Alternatively these baselines are now set at a reflective level, whilst the previous baselines were set incorrectly, in which case we believe that a review should be undertaken as to why and how certain baselines could be set at such an incorrect level, and the impact that this would have had on both consumers, Shippers and Transporters. The licence conditions being placed on NGG to facilitate the substitution, trade and transfer of entry capacity is further adding to the regulatory risks being faced by the industry, and it would appear is not being driven by the parties directly impacted, but by the regulator pursuing a conceptual theory. This is especially concerning given that a mechanism has been put in place to provide long term market signals and these mechanisms are being altered before the full impact of these mechanisms can be felt creating regulatory uncertainty and risk. The impact of this type of change can be most clearly seen at Easington where a physical constraint has been created due to the implementation of the current market mechanisms and change in periods that created mixed signals.

EDF Energy therefore remain unconvinced that the inclusion of spare capacity within the Transportation model will lead to a benefit to the industry. When setting reserve prices for entry and exit, of vital importance to the industry is their ability to predict what these future charges will be. The main benefit of the Transportation model was that it could be replicated by Users and would provide them with transparency and predictability for these prices, as they would be based on reasonably stable and transparent assumptions. In the past we rejected the inclusion of spare capacity within the model as in order to include this

parameter we would be reliant on NGG's assumptions as to likely future flows. These would not be transparent, could potentially be open to manipulation and would lead to unstable prices.

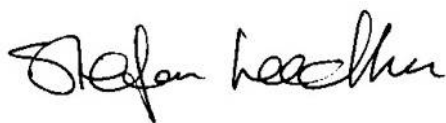
It is also clear that NGG's proposed method for inclusion of spare capacity, does not actually incorporate spare capacity into the model and rather uses forecast flows as a proxy. The existence of spare capacity suggests that the financial indicators provided through the auction process have not had time to work as NGG has provided more capacity than has been signalled. In addition economic theory states that the marginal cost of supplying this spare capacity is zero and so should be released at a zero reserve price. Historically this has been done through the short term auction process when Shippers were able to procure within day firm and interruptible capacity for a zero price. However the revision to baselines will have discouraged this process as Shippers who wish to utilise spare capacity are now open to the risk that the regulator will significantly alter the baselines again at the next TPCR with little or no warning. This can be seen most clearly by the experience of Excelerate Energy at the Teeside terminal. This issue has been further impacted by the licence conditions placed on NGG to facilitate the substitution, trade and transfer of entry capacity, creating a further risk to Users who wish to utilise spare capacity released at the day-ahead stage.

It would appear that the intent of the proposal is to encourage Users to book spare capacity long term and therefore artificially maintain the NTS in its current state rather than allowing it to develop in response to supply and demand signals. Given that offshore fields are unable to reallocate as a result of locational entry capacity signals, it is questionable what benefit this proposal will have in attracting additional sources of gas to where there is spare capacity. Even if this mechanism was effective the question should also be posed as to whether the UK should be signalling importers to locate where there is short term capacity available, rather than where the gas is required close to demand. It would appear that this proposed mechanism would encourage the use of short term spare capacity at the expense of ensuring long term locational and development signals are provided.

In order to develop a view on the likely utilisation of capacity at an ASEP, NGG are reliant on producers' views of what will be supplied through that ASEP, which is collated through the TBE process. There is therefore a potential for this process to be manipulated with the intention of reducing prices at particular ASEPs by submitting lower forecasts. This would lead to a cross subsidisation between ASEPs with those with forecast flows close to, or at their obligated levels, subsidising those with lower forecasts. This problem is endemic with this proposal, as even if accurate forecasts were made, the impact of reducing prices at certain ASEPs would lead to a larger under recovery of revenues than would have been experienced under the Transportation model as it stands. This will lead to a higher TO Commodity charge and will further commoditise a capacity charge, which under this proposal would also be based on expected commodity flows rather than delivered capacity. This does not appear cost reflective.

I hope you find these comments useful, however please contact me should you wish to discuss this further.

Yours sincerely

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

Stefan Leedham
Gas Market Analyst
Energy Regulation, Energy Branch

Appendix

Q1. Obligated NTS Entry Capacity prices are determined from the maximum forecast Base Case scenario, with Entry point specific analysis, such that each NTS Entry Point is at the relevant supply level and a supply/demand balance achieved via supply substitution. The relevant supply level should be the maximum forecast Base Case supply, capped at the Obligated NTS Entry Capacity level, at each NTS Entry Point (this will therefore be equal to or less than the Obligated NTS Entry Capacity level).

We do not believe that NTS Entry Capacity reserve prices should be determined using a maximum forecast Base Case Supply. As previously stated, it would appear that this scenario is open for manipulation from Users who provide these forecasts in order to secure lower entry prices at the ASEPs that they wish to utilise. Further this would lead to a larger under recovery of revenues leading to a higher TO Commodity charge than that predicted under the current transportation resulting in the commoditisation of a capacity charge.

Q2. This approach is an appropriate approach to factoring in spare capacity in that prices will decline if forecast flow declines hence creating an incentive to utilise spare capacity.

We do not believe that this is an appropriate approach as we do not believe that spare capacity should be incorporated into the Transportation model. We would also note that this proposal does not explicitly incorporate spare capacity into the model and is reliant on accurate forecasts, which could be prone to manipulation. Further this proposal also incentivises the maintenance of the current configuration of the NTS, rather than providing appropriate signals to locate gas supplies closer to the centre of demand. This appears neither economic nor efficient and ensures relatively short term capacity issues interfere with the long term investment signals.

Q3. This approach is consistent with National Grid NTS' proposed entry capacity substitution obligations as prices would not be influenced by Obligated NTS Entry Capacity level changes resulting from entry capacity being substituted from one entry point to another.

EDF Energy is aware of the impact that the substitution of entry capacity may have on entry capacity reserve prices. However we are concerned that this proposal is attempting to overcome an issue that has not even been incorporated into NGG's licence and with no visibility as to the mechanisms that may accommodate this. An alternative solution could be to move from obligated entry capacity to baseline capacity which is more stable within price control periods.

Q4. This proposal (NTS GCM 06) is implemented for price determination in relation to all entry capacity released from 1st October 2007 starting from the September 2007 QSEC auction.

In addition to the concerns that EDF Energy has with the processes that has lead to this consultation, we also remain concerned with the proposed implementation date. It would appear that in order to meet this deadline NGG will require a shortened veto period from Ofgem. Further this will negate the indicative entry capacity prices that have already been produced for 01 October 2007 and relies on the fact that Ofgem will not require an impact assessment (IA) into this proposal. Whilst we recognise that an IA has already been produced in relation to GCM01, we note that this proposal represents a material change to the original proposal and would question whether an additional IA is required. We feel that this is especially important given that the industry was opposed to the incorporation of spare capacity when originally consulted on, and it remains unclear whether there is any additional gas that will flow as a result of the implementation of this proposal.