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Dear Eddie

National Grid Consultation GCM19: "Removal of NTS Daily Entry Capacity Reserve Price Discounts".

EDF Energy welcomes the opportunity to respond to this consultation. We are opposed to implementation of this methodology at this stage.

Whilst EDF Energy has supported the entry charging review with the aim of addressing the variable and volatile TO Commodity charge, we do not believe that the solutions presented by National Grid Gas (NGG) represent the best solution. We also believe that the wider impacts of this proposal significantly outweigh any benefits that may be observed. We are concerned that:

- Implementation of this proposal will further add to the regulatory uncertainty in the UK. This could detract from further investment and so threaten the UK's security of supply position.
- This proposal has failed to undertake any analysis on the impact that this proposal will have on competition and Shippers. In particular no analysis has been undertaken to identify whether any particular "class" of Shipper books shorter or longer term entry capacity.
- This proposal could have a detrimental impact on prompt liquidity and NBP volatility by reducing the attractiveness of the UK for marginal gas supplies.
- Implementation of this proposal fails to reflect the operational requirements of Shippers who have a portfolio of offshore supplies and are unable to identify what their capacity requirements are in the longer term.
- Implementation of this proposal will reduce the attractiveness of maintaining declining offshore fields and so reduce the longevity of these fields. This will have a detrimental impact on the UK's security of supply and tax revenue.
- This proposal fails to take account of developments in Europe, and so runs the risk that this proposal will need to be reversed in the near future.

We have expanded on these issues within our detailed response to the questions posed in the consultation document.

EDF Energy therefore believes that this proposal should be rejected by Ofgem, subsequent to a full Regulatory Impact Assessment. Developments on the European regulatory regime should be allowed to materialise to ensure that any proposals are consistent with this regime and do not leave the UK in breach of these regulations. NGG should review the options of scaling up entry capacity prices – which is employed in the exit regime – so that they meet allowed revenue. This is the only option that will address the issue of the TO Commodity charge without having a significant detriment on the UK.

I hope you find these comments useful, however please contact my colleague Stefan Leedham (Stefan.leedham@edfenergy.com, 020 3126 2312) if you wish to discuss this response further.

Yours sincerely

Dr. Sebastian Eyre
Energy Regulation, Energy Branch

Questions for Consultation

Q1. Should the discounts that apply to day-ahead (DADSEC) firm daily entry capacity be removed?

No.

When planning investments to supply gas to the UK, Shippers and developers require a stable regulatory regime so that they can appraise their investment and take a sound financial decision.
Since setting NGG's price control for 1 April 2008 2013 the entry capacity regime has undergone significant and fundamental reform. This has included the re-setting of entry capacity baselines and the implementation of transfer and trade and substitution methodologies. All of these have had a fundamental impact on how Shippers procure and optimise their entry capacity requirements to supply gas to the UK. With developments in Europe regarding the charging for capacity and the mechanism for accessing this capacity, there is a further risk that the UK will also have to undergo further reform in the near future. This level of regulatory uncertainty has reduced the attractiveness of the UK for investment in recent years, an issue that has been raised in public meetings and consultation responses.

Project Discovery has identified the need for significant investment to meet the UK's security of supply requirements. We believe that implementation of this proposal would be in contradiction to the key findings of this project by further adding to the regulatory uncertainty that plights the UK.

EDF Energy would note that this is further exacerbated by developments in Europe, whereby charging regimes and capacity allocation mechanisms are set for fundamental reform. We are therefore concerned that were this proposal to be implemented there is a significant risk that this would have to be reversed in the very near future to ensure compliance with European requirements. Given the over arching requirements that will be imposed on the UK by European developments EDF Energy believes that implementation of any charging modification be delayed until it is clear what the European requirements are. This will reduce regulatory uncertainty for Shippers and ensure that they are not exposed to a continuous stream of regulatory change.

EDF Energy is also concerned that no analysis has been undertaken on the classes of Shippers that access the "shorter term" entry capacity products and the impact that this methodology may have on these Shippers. In particular we would note that there are numerous Shippers who book entry capacity, including larger "incumbent" producers; small producers who develop niche and declining offshore fields that are unattractive to the "major producers"; traders who contract for physical delivery; and "suppliers" who can arbitrage between markets for the delivery of their gas – such as LNG importers. No analysis has been undertaken as to whether any of these classes of Shipper are more reliant on any particular class of entry capacity. We are therefore concerned that implementation of this proposal could favour certain classes of Shipper over another. This could have a detrimental impact on competition if smaller suppliers are disadvantaged compared to the larger producers. This could have a detrimental impact on security of supplies if gas supplies are diverted to another market as the entry capacity charging arrangements are more attractive. Finally this proposal could reduce the liquidity of the gas market if traders are discouraged from taking short term physical positions to trade against.

EDF Energy believes that Ofgem should conduct a full Regulatory Impact Assessment focusing on these issues to ensure that the unintended consequences of this proposal do not outweigh the benefits.

EDF Energy is also concerned that this proposal ha failed to take into account the operational requirements of Shippers that operate offshore fields. In particular we would note that the UK Continental Shelf (UKCS) is in decline, and so there are numerous offshore fields that are nearing the end of their production life. However when operating these fields it is unclear how much longer they will be producing for, and so Shippers will not be prepared to lock themselves into a long term entry capacity product that they may not require. This therefore only leaves shorter term entry capacity products open to these Shippers. However whilst there is greater certainty around the short term requirements this tends not to materialise until the day ahead or within day period. This is driven by the production uncertainty surrounding these fields as they tend to be less reliable and subject to unexpected reductions or increases in production volumes. Increasing the entry capacity costs for these fields is likely to shorten their economic life and result in the closure of these fields earlier than expected. This appears to be in contrast to Ofgem's and the Governments stated position of encouraging production from these fields and maximising the asset life.

EDF Energy therefore believes that implementation of this proposal will have a detrimental effect on the UK's security of supply as the impact of this proposal will be felt most greatly by offshore fields that are in decline. This will also have a knock on impact on the tax revenues collected from these fields. This appears to be diametrically opposed to Ofgem's and the Government's stated position on these assets.

Finally EDF Energy would also note that at this stage the requirement for this change is not clear. As previously noted the UK entry capacity regime has undergone significant and fundamental change in recent years. All of these reforms have encouraged Shippers to book long term capacity products if possible, as there are significant risks associated with relying on shorter term capacity products that may not be available when required. However due to the lead time associated with QSEC bookings, these reforms will not feed through in to TO revenue recovery for another year or so. In addition the move from pricing based on UCAs to LRMCs is also due to start feeding through into revenue recovery for NGG in future years. Combined these proposals will increase the revenue recovered from capacity auctions and so reduced the size and impact of the TO Commodity charge. EDF Energy believes that in light of these developments no reforms should be put forward until the industry has a clearer understanding of the impacts of these changes on revenue. Implementation now would run the risk of NGG moving from an under recovery to over recovery in the near term.

Q2. Should the discounts that apply to within-day (WDDSEC) firm daily entry capacity be removed?

No.

The same issues that applied to Question 1 also apply to this question.

In addition we would note that currently the WDDSEC revenues are treated as SO Revenue and redistributed to Shippers through the capacity neutrality charge. Therefore any changes to WDDSEC pricing will have no impact on the TO Commodity charge until associated changes to NGG's Licence and a UNC Modification proposal are implemented. Whilst it is possible top implement the Licence change prior to 1 October 2010, we understand from discussions with NGG NTS that there is a 6 month lead time associated with the IT systems required to support the changes to capacity neutrality as identified. NGG has commented that they intend to progress the changes to capacity neutrality after implementation of this proposal and the associated Licence changes. This would mean that any revenue from WDDSEC auctions would be returned through capacity neutrality until 1 April 2011 or later.

EDF Energy is therefore concerned that implementation of this proposal will have no impact on the TO Commodity charge until April 2011 at the earliest. This is in contradiction to NGG's stated aim of reducing the size and impact of the TO Commodity charge.

EDF Energy would also note that implementation of this proposal without the associated changes to the capacity neutrality charge could have further unintended consequences of encouraging Shippers to book WDDSEC capacity. This is driven by the fact that the capacity neutrality charge effectively would reduce the cost of purchasing WDDSEC capacity, in proportion to the Shippers entry capacity holdings. For example a Shipper who held 30% of the entry capacity would benefit from a reduction in WDDSEC prices by 30% as a result of the capacity neutrality smear. With changes to the DADSEC charging arrangements this may further encourage Shippers to book WDDSEC capacity. At best this would therefore have a neutral impact on the TO Commodity charge.

EDF Energy therefore does not believe that there should be any changes to the WDDSEC pricing regime as it is contingent on other reforms which are not being progressed at this stage.

Q3. Should revenue from the sale of within-day Obligated Daily NTS Entry Capacity (if not redistributed via capacity neutrality) be treated as TO revenue for charge setting purposes?

No.

Whilst this appears to be a straight forward change to facilitate implementation of this proposal, we believe that further analysis if required to identify the impacts of this change. In particular we believe that further information and analysis is required to identify what (if any) impact this proposal would have on the SO Incentives, and whether re-classification as TO revenue would reduce the incentive on NGG to maximise the release of entry capacity.

We also believe that further analysis is required to identify how the release of WDDSEC capacity impacts NGG's role as system operator. In particular we would note that in discussions on NTS flexibility, NGG has claimed that flexibility also incorporates NGG's ability to accommodate changes in supply at the day ahead stage. It may therefore be appropriate to continue counting this revenue as SO, if the release of WDDSEC capacity impacts on how NGG runs it compressors and operates the system on a daily basis.

EDF Energy
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