

Steve Armstrong
National Grid House
Gallows Hill
Warwick
CV34 6DA



13 October 2006

Dear Steve

Response to Pricing Discussion Paper PDDN01 “Interruptible Charging Methodology Options for UNC Mod 0090”.

EDF Energy welcomes the opportunity to respond to this consultation. We would however continue to express our concern at the implementation of these reforms at the same time as the reform of the NTS Exit regime. We believe that the fundamental failings of these proposals are highlighted by the inability to identify and chose the appropriate pricing regime for these reforms to function under.

As identified in the pricing discussion paper, one of the core objectives of DN Interruption reform was to allow the Gas Distribution Network (GDN) Transporters to make the “appropriate economic decisions between the purchase of interruption rights and investment in network capacity.” This would be achieved by allowing Shippers to “place a value on the interruption they provide”. These objectives would suggest that Option B “Open Tender” would be the logical choice for achieving these objectives, providing a market mechanism for Shippers to reveal the value of interruption to them, thereby allowing Transporters to make a simple economic decision between purchasing the interruptible rights or investing in the network. EDF Energy would however note that due to the complexity involved with this option and the long lead times associated with this regime, then implementation of this option will act as a barrier to entry for Shippers and consumers offering interruptible rights. We would however note that the other two pricing options that have been developed also have serious failings. In particular we believe:

Option A: Administered Prices

- The only benefit of this option is that it is simple to implement, and so the pricing regime will not act as a barrier to entry to Shippers and consumers that may be prepared to offer interruptible rights to the Transporters.
- We would also note that due to its simplicity this would also represent the least cost option.
- However we do not believe that implementation of this option will achieve the fundamental objectives of DN Interruption reform. EDF Energy fails to recognise how this option will enable Shippers to reveal the true value of interruption, allowing Transporters to make economic and efficient decisions.
- EDF Energy would also note that a risk of implementing this option is that the “Administered Price” is set at an incorrect level. There is therefore a very real risk with this option that an inadequate level of interruption is contracted for, increasing the risk

of expensive capacity buys backs at a cost to the consumer, or the price is set too high and inefficient investment decisions are made.

- We would further note that implementation of this option would require Transporters to determine the price for each zone. It therefore appears that this option also has higher administrative costs for the Transporter, again at a cost to due to its simplicity Shippers and consumers.

Option B: Open Tender

- As already noted, in principle, this is EDF Energy's preferred option as it enables shippers to reveal the true value of interruption, allowing Transporters to take a simple economic decision to either invest in the network or purchase the interruptible rights on offer.
- We would also note that implementation of this option would allow Transporters to "trade off" investment delivery problems against accepting higher priced interruption if an inadequate level of interruption was offered through the tender process. I.e. Transporters would be able to accept a higher priced offer for interruption if they were unable to deliver the investment to make the site firm on time. This option would therefore provide transporters with greater flexibility if the volume of interruption tendered for was significantly less than required.
- However administration of this option would represent a significant cost to both Shippers and consumers, which could act as a barrier to entry, especially as the contractual relationship between a shipper and a consumer is generally for a 12 -24 month period, whilst interruption rights would be tendered for at least 3 years out. Whilst it may be possible to develop contracts to overcome this issue, under the current climate we do not believe that there is significant appetite amongst consumers for contracts in excess of 12-24 months, let alone out to the minimum 3 year period that this reform would require.
- In our opinion only the larger consumers with the resources available to devote to this type of tender would participate. There is therefore a significant risk that insufficient volumes of interruption are required and Transporters have to undertake significant investment at a cost to consumers.

Option C: Hybrid

- EDF Energy believes that implementation of this regime would reveal the value Transporters place on interruption, providing price transparency to the market. However we fail to identify the benefit of this as we believe Shippers and Consumers will bid close to the maximum price, if it is attractive to them. As with administered prices, this option will fail to achieve the fundamental objectives of DN Interruption Reform.
- It is also not clear under this option how the "maximum price" would be developed, in particular whether it would be based on the investment cost of reinforcing the network, or whether it would be developed in a similar manner to the administered price.
- We would further question how this Option would overcome the issues of complexity associated with the Open Tender. In particular we note that if Shippers are free to bid up to a maximum reserve price, then there would be as much complexity in identifying the bid price as under the open tender. If Shippers were able to bid at pre-set prices, for a set number of days, with various options for the option/exercise split, then we believe that this will be equally as complex as the Open Tender. For example a site could have a choice of 10 different option/exercise splits, with 9 different duration options, combined with 10 different pricing options, giving it a choice of 900 different options.

EDF Energy therefore believes that the Open Tender pricing option is the least bad of the three options presented, and is the only option that will allow the Transporters to achieve the relevant objectives identified by Ofgem in pushing through DN Interruption Reform. We would note that the costs to Shippers and consumers of implementing this option is significantly greater than implementing an administered price approach, however these

costs could be decreased by reducing the number of “variables” that were open in the tender process. I.e. allowing Shippers to set the price, but pre-setting the duration and option/exercise split options. We would note that a likely outcome of this approach would be differing price levels for interruption within a zone. We believe that this is an appropriate outcome with different consumers placing different values on interruption, and the open tender process revealing this. In relation to the timing of the tender process, we believe that this should be a function of the volume of interruption required, and the amount purchased, and not a function of the complexity of the regime employed. EDF Energy recognises the benefits of running a more complex tender process less often, however this is a fundamental reform of the DN Interruption process, and flexibility is required at an early stage to overcome any unforeseen circumstances. We would further note that under the proposals Interruption rights would be tendered for gas years Y+4 to Y+9, therefore for sites that wish to have long term stability and tender for these long periods then they will only have to participate in the process once every 5 years if they so chose.

I hope you find these comments useful, and please contact myself should you wish to discuss these in further detail

Yours sincerely

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

Stefan Leedham
Gas Market Analyst
Energy Market Strategy, Energy Branch