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Dear GDNs

Distribution Networks Pricing Consultation Paper DNPC03 "LDZ System Charges – Capacity/Commodity Split and Interruptible Discounts".

EDF Energy welcomes the opportunity to respond to this consultation. We do not believe that sufficient information has been provided to support this proposal. We have provided answers to the specific questions answered in the consultation as an appendix to this letter.

As an energy supplier EDF Energy is committed to reducing our customers' CO_2 production by 15% by 2020. We are also committed to our corporate social responsibility to protect the fuel poor and so have developed an industry leading social tariff to meet this commitment.

The issue of the capacity/commodity split for distribution charges is problematic and conceptually difficult. This issue has been consulted on a number of occasions, most recently in 2004[1] and 2000[2] and the majority of issues raised then remain today. Shippers are still awaiting the information to support the move to a higher capacity charge proportion, and the information provided to date has not facilitated this. EDF Energy therefore welcomes Ofgem's undertakings to conduct a full regulatory impact assessment into this proposal. In particular our concerns with this proposal focus on:

- The impact this proposal would have on the different classes of customers, especially the fuel poor
- The interactions with the Annual Quantity process
- The information that has been provided to support this proposal
- The impact this proposal would have on energy efficiency incentives
- The processes that this proposal has followed from initial development onwards

Fuel Poverty

We remain especially concerned that all of these options will have a negative impact on the fuel poor. As noted by the GDNs the impact of this proposal on the total level of charges paid by a consumer will depend on their load factor compared to the GDN average. Our own analysis has shown that in gas there is a far greater likelihood of reduced usage amongst the fuel poor, and a far greater likelihood that those classed as fuel poor will be drawing a

[1] Review Of Transco's Structure of Distribution Charges, Ofgem Ref 101/04
[2] Review of Transco's LDZ Charging Methodology, 2000

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pension. The Warm Homes and Energy Conservation Act 2000 Section 1 (1) defines fuel poverty as: "a person is to be regarded as living "in fuel poverty" if he is a member of a household living on a lower income in a home which cannot be kept warm at reasonable cost"[3], and we would note that the majority of gas consumption by domestic consumers is for heating purposes.This proposal therefore appears to be in contradiction to the Warm Homes and Energy Conservation Act 2000 Section 2 (1) which requires the relevant Authority to develop a strategy which includes: "the taking of measures to ensure the efficient use of energy that as far as reasonably practicable persons do not live in fuel poverty"[3], and in contradiction to Ofgem's primary duty to take account of the needs of vulnerable customers.

Annual Quantity Issues

The AQ for domestic customers is reviewed annually, and so there will always be a time lag of up to 12 months between a consumer changing their demand patterns and realising the benefit from this of reduced distribution charges. Further the only way to ensure that the AQ, and so capacity charges are accurate is by submitting meter reads to base the AQ on. If no meter reads are submitted, then the previous AQ will be rolled forward. Whilst credit customers have an incentive to submit meter reads to ensure that their bills are accurate, there is no such incentive on customers with pre-payment meters. Given the recent focus by consumers on energy efficiency in the face of high energy costs it is therefore likely that the AQs for these meters will be overstated. Moving to an increased capacity charge based on the registered AQ will therefore negatively impact on the fuel poor who are on a pre-payment meter and so are more likely to have an overstated AQ. EDF Energy's own analysis has shown that 25% of the UK are on a PPM, and 25% of those identified as being in fuel poverty have a PPM fitted.

The impact of this proposal on domestic charges appears to be based on the GDNs' assumptions that the AQs are accurate. However given the 12 month time lag associated with AQs, this assumption appears optimistic. If AQs are inaccurate then the impact of this change would be to increase charges for loads with overstated AQs and decrease charges for loads with an understated AQ. Given the recent reduction in domestic demand in response to higher prices and climate change concerns, it would appear likely that domestic AQs are overstated, in comparison to recent demand patterns. Therefore the impact of this change would be to increase the costs to domestic consumers as they wait for their AQs to catch up with their demand. EDF Energy's own internal analysis has shown that the impact of this change would equate to a £17 per customer increase in charges in instances where it was known that the AQ was inaccurate.

Information Analysis

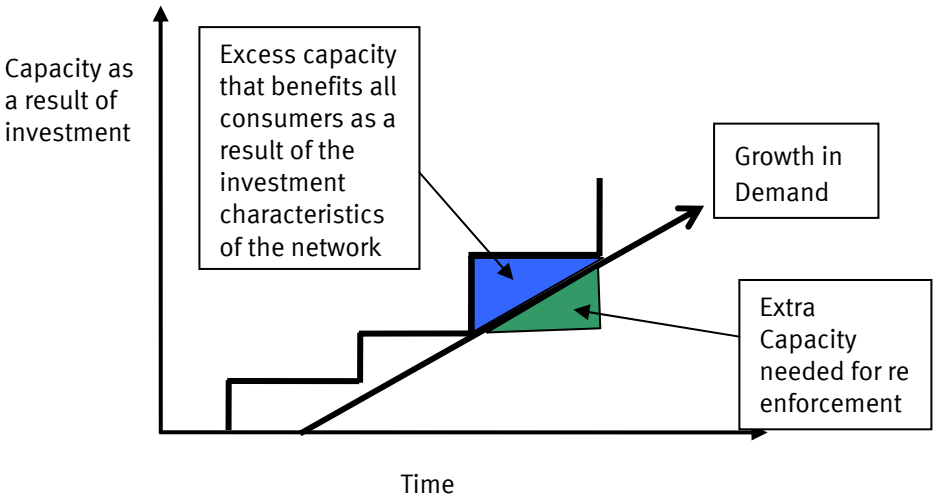
We also note that some information has been provided at a GDN level on the costs incurred which have been classified as fixed or variable, insufficient information has been provided to enable Shippers to identify whether these classifications are correct. We would note that in Ofgem's Gas Distribution Price Control Review (GDPCR) Consultation document (Ofgem Ref 49/07) it was suggested that the GDN's costs were 5-10% variable with throughput. Whilst close to the GDNs' assertions we continue to request clarification as to the divergence of these figures, especially as Ofgem will have more detailed information with which to analyse the variability of costs.

We would also note that this methodology represents an "averaging methodology" across the GDNs. No analysis has been provided as to whether the costs incurred for supplying

[3] Warm Homes and Energy Conservation Act 2000, http://www.opsi.gov.uk/Acts/acts2000/20000031.htm, accessed 21 August 2007.

different classes of customers vary from this split. We are aware that the electricity distribution networks have different capacity/commodity splits for different classes of users to reflect the costs involved in supplying these customers. These charges can vary between 100% capacity for the largest consumers to 100% commodity for domestic consumers. We therefore believe that further analysis needs to be undertaken to ensure that the costs of supplying different classes of customers reflect the costs incurred, and to ensure that there is no cross subsidy occurring between the different classes of customers.

We also note that network investment is characterised by step fixed costs such that investment in re-enforcement rarely matches the exact increase in demand placed on it (Figure 1) but rather outstrips it for a period of time if demand continues to increase. If this is the case the whole network benefits from increased flexibility as a result of the excess capacity (blue box) as a result of the re enforcement (green box) the charges should be developed accordingly to ensure that certain classes of customers are not funding capacity that the entire network benefits from.



Moving to a 95/5 capacity/commodity split will remove the weather impact on prices from the GDNs. We are however concerned that whilst the weather variability, and so the cash flow risk, will have been significantly reduced for the GDNs, this risk would have been passed on to the Shipping community, and so therefore customers. Shippers would seek to pass this risk on to consumers through the introduction of a standing charge to their tariffs, or introducing new tariffs that reflect the introduction of these new arrangements or increasing the risk premium associated with these tariffs.

Energy Efficiency

We also believe that the impact assessment should focus on the effect, and incentives that this proposal would have on energy efficiency. Given the recent focus on energy efficiency by both consumers and the Government, we are concerned that the introduction of a higher standing charge or base loading of charges will have a negative impact on the incentives to

improve energy efficiency. Implementing this split would mean that a larger proportion of consumers' charges would remain fixed and so, there would be a significantly reduced incentive to reduce energy consumption below a certain level as the transportation cost base would remain.

Process

The scaling factors provided by the GDNs from which charges could be developed were only provided on 13th August 2007, half way through the consultation process. This information was originally requested at the Gas Distribution Charging Methodology Forum (GDCMF) on 19th April 2007. This information is vital to Shippers to analyse the regional and distributional effects on customer classes that this proposal would have, and should have been provided at the start of the consultation process.

We also remain concerned that this proposal has been developed by the GDNs in conjunction. One of the main benefits identified by Ofgem as part of the GDN sale was the potential for comparative regulation, as witnessed in the electricity distribution networks. A key benefit of having multiple owners is that it should increase innovation within the industry. In electricity distribution we are aware that a number of DNOs are currently developing different charging methodologies. Consequently, the regulator is presented with a range of approaches and hence is provided with the ability to indicate what they believe to be the most cost reflective methodology. This approach spreads best practice which can only be to the benefit of all users of the network

However this is not the case in gas, with the GDNs developing a methodology that reflects the lowest common denominator. We therefore believe that an opportunity for comparative regulation is being missed and would encourage Ofgem to ensure that the benefits of comparative regulation, already realised in electricity are also realised in gas.

Yours sincerely

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Energy Branch

Appendix I

a) **Should the Charging Methodology be changed so that the capacity element of the LDZ System charges is set to recover 95% of the revenue from the LDZ system charges, and the commodity element is set to recover 5% of the revenue, compared with the current 50%/50% target split?**
As previously stated we are unable to determine whether this split of charges accurately reflects the costs incurred from the information provided. We note Ofgem has in the past rejected a change to a 90/10 capacity/commodity split on the grounds of insufficient information, and we do not feel sufficient information has been provided to support this proposal. As noted in our response above the electricity distribution networks have a varying capacity/commodity split dependant on the size of the customer and it would appear beneficial to identify whether the variability of charges varies with the class of customer connected. Whilst we welcome more stable charges we are also concerned of the impact that this proposal may have on the fuel poor and energy efficiency incentives.

b) **Should interruptible supply points pay 47.37% of the increased LDZ capacity charge so as to maintain the value of the discount received by interruptible supply points at its current level on average?**

As with the capacity/commodity split, EDF Energy requires further information in order to assess whether the charges for interruptible supply points would be cost reflective under this proposal. We note that the current interruptible discount is set at a level to reflect the fact that no capacity reinforcements will be required to support this load. The fact that the GDNs now appear to believe that their charges are 95% capacity related suggests that these interruptible loads have in fact been subsidising the firm loads. Whilst we therefore recognise that the proposed discount maintains the current level of charges at a GDN level for interruptible supply points, it is not clear whether this is cost reflective, and the GDNs' own consultation appears to suggest that it is not.

c) **Should this change be made with effect from 1 April 2008 or 1 October 2008?**

As a Shipper with a largely domestic customer base, we will require sufficient time to change our tariff structures to reflect any change to a capacity/commodity split, and therefore support a longer lead time. We therefore believe that a 1 October 2008 date is preferential to a 1 April 2008 date. However this may still not be sufficient notice to ensure that our tariffs reflect this change. We would note that the GDPCR is still being consulted upon, and no proposals have been made as to how the interruption regime will be incentivised, and so how the costs associated with this will be accounted for. We further note that the outcome of exit reform remains unclear, and so the impact on GDNs costs can not be identified. We therefore believe that it is important that the impact of these changes on the cost base is known in order to avoid numerous reforms to the capacity/commodity split as these reforms develop. We therefore continue to believe that a 1 October 2008 implementation date is too early.