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UNC Panel Secretary
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06 February 2009

Dear John

EDF Energy Response to UNC Modification Proposals 0228 & 0228A “Correct Apportionment of NDM Error – Energy”.

EDF Energy welcomes the opportunity to respond to this consultation; we support implementation of modification proposal 0228 and 0228A. In terms of preference our favoured modification proposal is 0228, although we would note that this is marginal.

EDF Energy was an active participant in development workgroup 0194 and has supported the work undertaken to date to support both of these proposals. We have also actively participated in review group 208 and welcome the work that this group has produced to develop incentive arrangements to reduce the volume of unallocated energy. We believe that both of these workgroups have functioned generally as the modification rules intended, and the raising of modification proposal 0228A demonstrates the effectiveness of how the modification rules work to ensure a variety of options are consulted upon.

As recognised by Ofgem in its decision letter on modification proposals 0115 and 0115A, we believe that there is a fundamental flaw in the UNC whereby all of the unallocated energy costs are borne by the SSP market. The evidence provided to 0194 development workgroup clearly demonstrated that this was creating a cross subsidy from the SSP market to the LSP market, and this should be corrected.

EDF Energy would note that there has been a recent flurry of UNC Modification proposals designed to improve energy allocation. These include modification proposal 0204 which was implemented with effect from 1st October 2008, and modification proposal 0218 which is currently with Ofgem for a decision. EDF Energy believes that these proposals will improve the allocation of energy to the NDM supply points, in which case it would appear that the remaining RbD “smear” would represent the volume of unallocated energy on the networks. It would therefore appear appropriate to utilise the RbD mechanism to allocate this energy.

However EDF Energy also recognises that the appropriateness of the RbD mechanism was outside of the scope of development workgroup 194, and so no evidence was presented to the group on this issue. However given that unallocated energy is currently wholly funded by the SSP market, then any proposal to rectify this situation must be seen as an improvement on the current arrangements. EDF Energy therefore also supports 0228A. However we would note that neither of the proposals has provided evidence to support their assertion that RbD is, or is not, the correct mechanism.

EDF Energy is concerned with modification 0228A's proposal to allocate unaccounted for gas on a fixed volume with no annual profile. Proposal 0228A relies on the shrinkage arrangements set as part of the Gas Distribution price Control Review (GDPCR) for 2008-13 to support this approach. We would note that in paragraph 7.15 of the Final Decision Document on GDPCR, Ofgem note that:

“Own use gas and theft represent a relatively small proportion of total shrinkage and variations in quantities are not sufficiently material to justify the additional complexity of retaining a volume driver for these elements.”

It would therefore appear that Ofgem chose this model on the grounds that the complexity of administering dual arrangements for a relatively small percentage of total shrinkage outweighed the benefits that would be realised. However it would appear that theft is a significant element of unaccounted for energy, along with unregistered and orphaned sites. Whether these volumes will represent a flat, fixed volume throughout the year, or follow a seasonal profile will depend on the use that this gas is being put to, and we would note that in the LSP sector there are numerous profiles to reflect these different requirements. However given the difficulty in trying to ascertain the volumes of gas that are being stolen, or consumed by unregistered or orphaned sites, it would be virtually impossible to ascertain the profile of this consumption. EDF Energy therefore agrees with modification proposal 0228A that the industry should look to the GDPCR for guidance on how to treat these volumes, but would note that the GDPCR appears relatively clear that these should be linked to throughput.

Finally we would question proposal 0228A's treatment of shrinkage error costs that are not accounted for by the Transporters' allowance. We would note that it is currently accepted that shrinkage is recovered from all supply points based on throughput. Modification 0228A's proposal to only recover any error in shrinkage costs from the NDM market appears inconsistent with this principle, and would therefore question why they have opted for this treatment.

In addition to the comments raised in the draft modification report, EDF Energy would make the following observations:

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) to (b), the efficient discharge of the licensee's obligations under this licence:

Standard Licence Condition 4D requires all of the GTs to not discriminate between market participants. From the evidence presented to development workgroup 228, it is clear that the LSP Sector contributes to the volumes of unallocated energy; however all of the costs for unallocated energy are borne by the SSP Sector. Implementation of both proposals would provide a framework which would help to ensure costs are correctly targeted and so help to facilitate Standard Licence Condition 4D.

We would however note that by choosing a flat profile for the allocation of energy to the LSP sector, there is a possibility that a cross subsidy from the SSP to LSP sector would remain. In particular we would note that the GDPCR appeared to recognise that theft varies with throughput and so follows a seasonal profile. There is therefore a risk that the LSP sector will be over allocated unaccounted for gas in the summer, when prices are lower, but under allocated gas in the winter when prices are historically higher. This would appear to continue with the cross subsidy, although at significantly reduced levels from what is currently present.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant Shippers:

A driving force behind a competitive market is to ensure that costs are correctly targeted at those who are causing them to be incurred. Implementation of both proposals would make it easier for Shippers to propose different allocation of costs, and so help to ensure that costs are correctly targeted, thereby facilitating competition.

In addition whilst this may increase the risk that the LSP sector has to fund the gas that it is consuming, this will conversely reduce the risk for SSP suppliers that they will have to fund gas consumed in the LSP market. It would therefore appear that both proposals re-attribute risk to the appropriate market sectors, which could also be viewed as being beneficial to competition.

Standard Special Condition A11.1 (f): so far as is consistent with sub-paragraphs a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code:

By introducing a framework into the UNC, both proposals would make it easier to propose different allocations, thereby facilitating efficiency in the administration of the UNC.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk.

Consequence for the level of contractual risk for Users

As previously noted EDF Energy believes that both proposals would ensure that risk is re-attributed to the appropriate market sectors. However we would note that the degree of this re-attribution varies between proposals.

EDF Energy believes that whilst proposal 0228A will reduce risk to SSP Shippers and increases it to LSP Shippers, this will be offset by the introduction of a flat profile for unallocated energy to LSP Shippers. In the GDPCR Ofgem appears to recognise that theft varies with throughput. There is therefore a risk that unallocated energy is misallocated between market sectors throughout the year. Given the existence of a summer/winter spread in prices, EDF Energy believes that this will increase risk to SSP Shippers and decrease risk to LSP Shippers, compared to proposal 0194.

10. The Analysis of any advantages or disadvantages of implementation of the Modification Proposal

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Advantages

- Provides a framework which simplifies subsequent change to the allocation of RbD energy.
- Re-attributes risk to the appropriate market sector.
- Uses the RbD mechanism with which the majority of Shippers are familiar with. However no evidence has been provided to demonstrate whether it is appropriate or not.
- Facilitates Gas Transporter Standard Licence Condition 4D.

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Advantages

- Does not utilise the RbD mechanism, which may appear attractive to some LSP Shippers. However no evidence has been provided to demonstrate whether this is appropriate or not.

- Re-attributes risks to the appropriate market sector, although not to the same degree as 0228.
- Facilitates Gas Transporter Standard Licence Condition 4D.

Disadvantages

- Uses a flat profile for the allocation of unaccounted for gas to the LSP market this appears to be in contradiction to Ofgem's views in the GDPCR on theft profiles.
- The use of a flat profile potentially creates a cross subsidy from SSP to LSP Shippers.
- Different treatment of shrinkage errors to the DM market, compared to the shrinkage regime.

I hope you find these comments useful, however please contact my colleague Stefan Leedham (Stefan.leedham@edfenergy.com, 0203 126 2312) if you wish to discuss this response further.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Seb Eyre'.

Dr. Sebastian Eyre
Energy Regulation, Energy Branch