Attachment

Ofgem Consultation 210/09: "User Commitment for National Transmission System Quarterly Entry Capacity Initial Impact Assessment on modification proposals"

EDF Energy's detailed response to consultation questions

CHAPTER: Two

Question 1: Do you have any additional views on the merits/disadvantages of the options for securitization of capacity to add to those of the review group?

EDF Energy agrees that the review group appears to have covered most of the advantages and disadvantages associated with the options identified. However it appears that the review group only focused on securitising all capacity booked in the QSEC auctions. We would note that this appears to fail to take into account the different risk exposure between an asset that is due to be delivered and one that has already been delivered. In particular we would note that once an asset has been delivered then there is a financial value associated to that asset. If the company that owns the asset fails, then it is likely that another company will step in and continue to utilise the asset, and so therefore the capacity that is needed to support the asset will continue to be acquired. Therefore the risks associated with this capacity booking are significantly lower. Conversely for a new project there is a risk that the asset will never be delivered, in which case the booked capacity will not be required. Project failure can be caused by numerous different issues, including company failure, failure to obtain planning permission and failure to gain the required financing. In this instance the risks are much higher and so the securitisation requirements should reflect this. Due to the complexity of the arrangements for releasing long term capacity in gas, any solution that resolved this would probably also be complex, however by failing to address this, the review group does not appear to have reflected the risks involved.

EDF Energy also disagrees with the review group's decision to accept NGG's proposal to limit security to either a Deposit Deed or Letter Of Credit (LoC). This requirement is too regressive as it is standard practice to also include the underlying credit quality when assigning credit levels. Credit ratings and requirements are by their very nature discriminatory as they are bespoke to the companies and reflect the apparent risks associated with them. However this is due discrimination as it is specific to companies. Failure to take this into account will impose costs on Shippers and consumers and fail to take into account the risks involved. We believe that the risk assessment mechanism as appropriately developed by the workgroup was an appropriate mechanism to reflect these issues and we therefore feel that this should have been progressed.

Question 2: Do you have views on the ability for NGG to cover the potential of shipper default through commercial insurance instruments?

EDF Energy does not have any views on this. However we would note that any insurance mechanism should create the correct balance between the cost of the instrument against the risk that is being insured.

CHAPTER: Three

Question 1: Do you agree with the analysis of the risks involved? Are there any quantifiable risks that have been omitted?

EDF Energy agrees with Ofgem's analysis of the risks involved. However on a minor point we would note that VAT is due to increase to 17.5% with effect from January 2010. As these proposals are unlikely to be implemented prior to this date, it may be appropriate to use this rate of VAT rather than the 15% that is currently utilised in the IA.

Question 2: Is the level of securitization being proposed appropriate? If not, why?

At a general level 10% securitisation is appropriate for existing assets. However we would note that for new projects requiring investment this is in direct contrast to the electricity arrangements were connecting generators can chose between FSL and IGUC for their security requirements. In these instances the level of securitisation is greatly in excess of the 10% being suggested. As noted previously the risks around an asset that is in existence is different to the risks around a project that is due for delivery in the future. It would appear that any securitisation regime should reflect these differences in risk in the securitisation required.

Question 3: Do you agree with the benefits as presented here? Are there any other ways in which the quantitative benefits could be presented?

Ofgem agrees with the benefits identified by Ofgem.

Question 4: How do the risk ranges presented for each of the proposals rank against your perceived risk of default for future capacity bookings?

As recognised by Ofgem in the IA, EDF Energy believes that the level of default required to produce a net benefit is an average across the industry. However the majority of capacity is booked by lower risk Shippers and so the default rate for the higher risk Shippers will have to be greater to provide a positive NPV. In addition as noted by Ofgem the impacts of default for Shippers with muti-entry point is significantly greater than the impact of default for a single entry point Shipper. It would therefore appear that there would have to be a very high level of default for “higher” risk Shippers at single entry points than the analysis has identified.

Question 5: Do you have any preference amongst the proposals on the basis of the quantitative analysis?

Based on the analysis conducted by Ofgem EDF Energy remains supportive of UNC Modification Proposals 0246A and 0246B with a preference for 0246B.

<u>CHAPTER: Four</u>

Question 1: Do you think that the implementation of any of these proposals would have an adverse effect on competition? Please give reasons for your answer.

EDF Energy agrees with Ofgem that these proposals may appear to hamper competition if they prevent new projects being delivered to the market. However the more relevant point is that if a project can’t afford to raise a LoC in the first place then their ability to deliver the project should be questioned. Fro EDF Energy we may not always get cash/LoC when we ask because of reluctance due to the increased costs but that is more of a concern when we think it is not because of a policy decision but more because they don’t have the cash or credit line available to provide that. Therefore whilst these proposals may appear to have an adverse impact on competition we believe that sound projects will continue to be delivered and only those projects that are not financially viable will be filtered out, thereby protecting consumers.

Question 2: Do you think any of these proposals are unduly discriminatory?

Ofgem’s point regarding the potentially discriminatory impacts of 0246B are relevant, however we would note that this is transitory in nature and after a period of time all Shippers will be exposed to the same costs. Conversely we would also note that amending the rules for capacity that has already been booked would also appear discriminatory as the costs and NPVs of the projects booking the capacity will be amended after the investment decision has been made. Arguably this would be a retrospective change and so discriminate against projects who have already booked capacity.

We would also note that as previously mentioned credit, and credit ratings are by their very nature discriminatory, but we consider this to be due discrimination as it reflects the risks and costs associated with each particular company.

Question 3: Do you think the proposals are sufficiently simple and transparent?

Compared to the auction arrangements, capacity allocation mechanisms and capacity release methodologies employed in the QSEC auctions these proposals are all very simple.

Question 4: What is your preference on the basis of the qualitative issues?

Based on the analysis conducted by Ofgem EDF Energy remains supportive of UNC Modification Proposals 0246A and 0246B with a preference for 0246B.

CHAPTER: Five

Question 1: Do you think that shipper termination is a tool that should be more widely used to deal with credit default issues?

EDF Energy believes that Shipper termination could be an appropriate tool for dealing with credit default issues, however we believe that if it were to be used it should be viewed as a tool of last resort. This will therefore require clear rules and guidelines to be produced that would outline the processes and timelines that would lead to a termination. This should help to provide certainty to Shippers that termination will only be enacted as a final tool to manage the industry's exposure.

Question 2: Do you agree that the Income Adjusting Event clause in the gas transporter licence should be reviewed? If so, what manner of changes would you recommend?

EDF Energy agrees that the Income Adjusting Event (IAE) clause should be reviewed. In particular we understand that the current wording of the IAE clause limits Shippers to raising IAEs when there has been a material change in operating costs. However it appears that this should be expanded to include a material change in all costs, or revenue that was not expected when the price control was set. The issue will be around setting criteria that are wide enough to cover most unforeseen events, whilst ensuring that they are not so lose that NGG is exposed to the risk that numerous IAEs could be raised for minor issues.

Question 3: Do you agree that the revenue driver mechanism for gas entry capacity could be improved? If so, how?

We agree that the revenue diver mechanism for gas entry should be improved. In particular we support the proposal from the review group that a phased release of revenue should be developed that would coincide with NGG's investment decisions. We believe that this should be a generic process to provide certainty for NGG, whilst also ensuring NGG only receives revenue to cover the costs that they are likely to incur. This should strike the correct balance between ensuring that NGG is reimbursed for their investment costs that are reasonably incurred, whilst also ensuring that NGG's revenue does not increase significantly where no investment is required.

Question 4: Do you have a view as to whether the Authority's role in the approval of NGG NTS proposals to release incremental capacity is no longer required?

EDF Energy believes that the Authority's current role in approving the release of incremental capacity provides an appropriate check and balance on NGG. At the same time we recognise that this is a mechanistic process that may provide uncertainty for investors. We therefore believe that it may be beneficial for Ofgem, or the Authority, to produce guidance document on how this process works and in what circumstances, if any the Authority would prevent the release of incremental capacity. This should ensure that the appropriate checks and balances on NGG remain in place, whilst also reducing the uncertainty for investors.

Question 5: Are there any other options, outside of the UNC, that could be considered for making the entry capacity credit arrangements more robust?

We agree with Ofgem's view that it may be appropriate to review NGG's risk exposure to defaulting Users. In particular we would note that NGG's allowed rate of return was set at greater than the risk free at the last TPCR review. This would suggest that NGG should be exposed to risk, including a proportion of default risk. This would place an incentive on NGG to actively manage Shippers who were at risk of default and take appropriate actions to limit their exposure.

EDF Energy
November 2009