Nigel Nash
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25 January 2010

Dear Nigel

Identification and Apportionment of Costs of Unidentified Gas – Impact Assessment

EDF Energy welcomes the opportunity to respond to this Impact Assessment (IA). EDF Energy continues to support implementation of all of the UNC Proposals. However, we have a strong preference for implementation of UNC Modification Proposals 0228 and 0228A over 0229.

The current arrangements of allocating all of the costs of Unidentified Gas to the SSP sector are clearly inequitable leading to a cross subsidy from the SSP market and consumers to the LSP market. This is detrimental to competition in the SSP sector and places on incentive on LSP market participants to detect and investigate causes of unidentified gas. This ultimately places all of the risk on the SSP Shippers and ensures that those Shippers in the LSP market have no financial burden as a result of their actions. We therefore welcome the progress that has been made on this issue to resolve the cross subsidy that has been in place for the last decade and ensures that costs are targeted at those market sectors who are responsible for them and can influence their outcomes.

We have some concerns with the Impact Assessment issued by Ofgem into these proposals. We have provided details and comments on this in response to the questions within the IA as an appendix to this letter. Our high level concerns are:

- Ofgem's analysis of the Impacts of Consumers as contained within Table 2 is flawed. Our own analysis indicates that Ofgem has overestimated the impact by several hundred per cent.
- The impact of exposing the LSP market to the RbD mechanism has been greatly overstated. The vast majority (if not all) I&C Contracts contain a re-opener clause in instances of unexpected changes in costs. This could be utilised to accommodate implementation of 0228 and 0194.
- Suggesting that exposing the LSP market to an element of RbD would have a detrimental impact on competition is unsubstantiated. The SSP market is fully exposed to RbD. However, Ofgem's own appraisal of the SSP market found that this was a competitive market, despite also cross subsidising the LSP market.
- The Gas Distribution Price Control Review (GDPCR) for 2008-13 concluded that theft and unidentified gas was correlated to throughput, although a fixed quantity for shrinkage was implemented for simplicity and because unidentified gas was a

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relatively small proportion of these costs. Ofgem's IA fails to take these findings into account and does not recognise the negative impact that a flat profile would place on the SSP market.
- The cost of the time that implementing proposal 0229 will take has not been taken into account. Our own analysis has concluded that 0229 can not be implemented until 1 April 2011 at the earliest, whilst 0228 and 0228A could be implemented with almost immediate effect.

Although we have the above concerns we continue to believe that all modification proposals will go some way to rectify the current cross subsidy and so ensure that costs are targeted at the market sector that is responsible for them. As proposals 0228 and 0228A can be implemented with almost immediate effect then we believe that Ofgem should direct implementation immediately. This will rectify the current default and ensure that an extensive and lengthy implementation process is avoided. We also believe that were Ofgem to continue to be minded to accept 0229, then a potential solution would be to direct implementation of 0228 or 0228A, which could then be superseded by 0229 when a methodology had been developed and was ready to be implemented. Alternatively Ofgem could also direct implementation of 0229 so that the methodology had effect from a specific date. This would allow the methodology to be developed and applied from the date specified by Ofgem, this could be before the methodology was completed but after the direction to implement. This would avoid any issues of retrospectivity whilst ensuring that the SSP Market and domestic consumers did not continue to cross subsidise the LSP market for an excessive period of time.

I hope you find these comments useful and constructive, however please contact Stefan Leedham (Stefan.leedham@edfenergy.com, 0203 126 2312) or I if you would like to discuss this further.

Yours sincerely

Guy Buckenham
Director of Strategy, Regulation and Planning

EDF Energy response

Impact Assessment Questions

CHAPTER: Three

Question 1: Do you agree with Ofgem's assessment that the likely impact of the Modification Proposals on charges made to consumers?
EDF Energy does not agree with Ofgem's assessment of the impact on charges to consumers. Our own analysis has indicated that implementation of proposal 0228 would only reduce the average domestic customers' bill by £1.28 per annum compared to Ofgem's estimate of £2.36 per annum. We have provided a detailed explanation of our analysis and its results as a confidential response to this IA. We would expect a similar impact from proposal 0228A. We also believe that Ofgem has significantly over estimated the impact on NDM LSP Customers and would request further information as to how this was calculated.

It would appear from our perspective that these charges have been over estimated, and so the consequential impacts on the LSP market have also been over stated.

Question 2: Do you consider that the proposed governance arrangements under UNC229 offer adequate protection to the interests of consumers in their present form?
As identified within the consultation one of the likely outcomes of Ofgem's Governance Review is that Consumer Focus will become a voting member of the UNC. We would also note that this is also being discussed under UNC Review Group 0267. Whilst currently there is no voting consumer representative we believe that this issue will be addressed soon. However, we would note that currently the UNC Panel is weighted in favour of Shippers with a large LSP exposure, even though they represent a very small minority of sites – as identified within Appendix 4 of Ofgem's Impact Assessment. EDF Energy would therefore be concerned if these positions were used to ensure any AUGE or methodology was favourable to the LSP market. We understand that this is also within the scope of Review Group 0267.

Question 3: Do you anticipate any further impact upon consumers in addition to those considered in this chapter?
Ofgem has not considered the time delay associated with implementing proposal 0229. As previously noted our own analysis has suggested that the earliest this proposal could take effect would be 1 April 2011. Even this is quite a tight timetable to appoint an AUGE, ensure a suitable contract is in place, to develop a methodology and keep the notification timetable as required under 0229. It therefore appears likely that this proposal will not result in a reallocation of energy until 1 April 2012 at the earliest. Based upon a 4% Vanilla WACC (as proposed in Ofgem's Capacity Output Incentive Consultation) this would result in a cost to the SSP market of £25.8m. Proposals 0228 & 0228A can be implemented with almost immediate effect and so these costs would not have been incurred.

CHAPTER: Four

Question 1: Do you agree with our assessment that any of these Modification Proposals will have an effect upon incentives for shippers to reduce the quantity of Unidentified Gas offtaken at LDZs?
As recognised by Ofgem there are currently no incentives to reduce the quantity of Unidentified Gas in the LSP sector as the costs are borne entirely by the SSP sector, therefore exposing LSP Shippers to these costs should also provide a financial incentive. However, we believe that the correct allocation of Unidentified Gas will actually increase the incentive on SSP Shippers to reduce the quantity of Unidentified Gas in the SSP sector. This is due to the fact that a 10% reduction in SSP Unidentified Gas currently equates to an 8% reduction in

exposure to Unidentified Gas costs as SSP Shippers are also cross subsidising the cost of LSP Unidentified Gas. Removal of this cross subsidy would result in a 10% reduction in SSP Unidentified Gas resulting in a 10% reduction in Unidentified Gas costs for the SSP market, thereby increasing the incentive.

Question 2: Do you agree with our assessment of the likely distributional impact of the Modification Proposals?
EDF Energy notes that Ofgem has recognised that some LSP Shippers have argued that this will have a negative impact on competition as Shippers that operate in both markets will be able to maintain the cross subsidy from SSP to LSP market and so gain a competitive advantage. EDF Energy fundamentally disagrees with this. The assumption appears to be that the SSP market is not a competitive market and so Shippers who operate in both the LSP and SSP market will be able to maintain their SSP prices to cross subsidise their LSP business. However, Ofgem's own supply probe has found that the SSP market is competitive. Further more there are Shippers whose exposure to the LSP market is so small that they could be considered an SSP only Shipper. It is therefore likely that even were a Shipper with a SSP and LSP market share chose to maintain the cross subsidy they would find themselves uncompetitive in the SSP market, losing market share and so being unable to maintain the cross subsidy.

Question 3: Do you believe that the potential benefits of the Modification Proposals justify the additional costs which may be imposed on customers?
EDF Energy does not understand this question. All of these proposals do not create costs, but merely aim to ensure that they are targeted at the correct market sectors and remove the current cross subsidy from SSP to LSP market. Whilst we recognise that there is an implementation cost of £110,000 to £360,000 this equates to a cost of between 1p to 2p per customer if it was recovered based on supply points only. This compares to a reduction of £1.41 per domestic customer based on our analysis. For SSP consumers there are no additional costs, only a more accurate allocation of costs.

Question 4: Do you agree that applying a variable RbD charge upon LSP shippers would potentially entail a negative impact upon competition? Do you feel that this potential impact justifies the imposition of a fixed rather than variable charge on LSP shippers?
EDF Energy does not believe that applying a variable RbD charge will have a detrimental impact on competition. We are aware that the majority of I&C contracts have a re-opener clause which allows the contracts to be reviewed in response to a material change, including regulatory reform. If the impact of applying RbD to LSP Shippers was as significant as some LSP Shippers have suggested then we would expect these re-openers to be enacted, where the RbD costs have not been built into the contract. We would also note that some I&C contracts allow cost pass through of certain costs, for these contracts we would not expect any change with the RbD costs passed through by the Shippers.

EDF Energy would also note that the SSP market has been fully exposed to the RbD mechanism for more than 10 years, and has been cross subsidising the LSP market. This is a competitive market, as found by Ofgem's supply probe. If RbD was a barrier to entry and had a detrimental impact on competition, as suggested by some LSP Shippers then we would expect this to be reflected in the Ofgem's conclusions, which is not the case. Given that the SSP market can build the costs and risks of RbD into their tariffs we see no reason why this can not be replicated in LSP tariffs with no detrimental impact.

Finally EDF Energy would note that in the GDPCR for 2008-13 Ofgem recognised that the Unidentified Gas Costs funded by Transporters was linked to throughput. However, these costs and volumes were relatively a very small proportion of total shrinkage costs. Ofgem therefore decided to have a single fixed level for shrinkage as it was deemed inefficient and uneconomic to have a throughput related mechanism for a relatively small proportion of shrinkage. These proposals deal only with unidentified gas costs, and so it would appear inconsistent were Ofgem to apply a fixed volume rather than a variable of RbD. This would place all risks of error and seasonal variation on the SSP market. Given that the LSP market has already benefitted from a significant cross subsidy for the past 10 years we believe that this would be inequitable.

Question 5: Should any third party authority created under the terms of UNC229 be tasked to review incentives for investigating theft upon individual shippers?
There are numerous development and modification proposals being developed to incentivise the detection and investigation of theft, we therefore do not believe that the AUGE should also review these. In particular we are concerned that further expanding the scope of the AUGE will add significant costs and delay the removal of any cross subsidy post 1 April 2012.

CHAPTER: Five

Question 1: Do you agree with Ofgem's assessment that any impact on sustainable development as a result of these Modification Proposals is likely to be marginal?
EDF Energy agrees that any impact on sustainable development will be marginal.

Question 2: Do you agree with Ofgem's assessment of the relative impact on sustainable development of each of the Modification Proposals?
EDF Energy believes that the modifications will have an equal impact on sustainable development. We see no reason why 0229, or any other proposal will have a more significant impact than any others. However, due to the inherent delay that would accompany implementation of 0229, it is possible to argue that any improvements to sustainable development will be delivered more quickly by 0228 and 0228A.

Question 3: Do you consider that there are any further impacts on sustainable development that are likely to result from the Modification Proposals?
No.

CHAPTER: Six

Question 1: Do you anticipate any impact on health and safety as a result of these Modification Proposals? If so, what?
No.

CHAPTER: Seven

Question 1: Do you agree that implementation of UNC229 would leave parties with adequate recourse to query decisions made by the AUGE?
There may be instances when a Shipper would wish to appeal the decision of the AUGE and UNCC. The modification route would appear to be a lengthy process to facilitate this, and would require the UNC Panel (who are also the UNCC) to opine on any proposal. It would appear quicker were a bespoke query arrangement to be implemented, as ultimately Ofgem would opine on any mod, it would appear reasonable to expect them to opine on any query. This could potentially utilise the UNC Disputes process under Section A.

Question 2: If not, how should any additional governance be implemented?
As previously noted a simple solution would be to allow a dispute under UNC Section A, with Ofgem acting as the approved expert for a decision.

Question 3: Are there any additional risks which may be placed upon industry parties by implementation of the Modification Proposals within scope of this Impact Assessment which we have not identified in this document?
EDF Energy is not aware of any additional risks to those we have already highlighted.

Question 4: How could the Governance Arrangements for appointment of an AUGE be structured to minimise impact upon shipper parties? Should GTs be indemnified from any risks from holding this contract, and if so how might this be implemented in practice?
It would appear more appropriate to allow the AUGE to be appointed by interested/impacted parties with the UNC Panel ratifying the outcome. This could be by allowing all impacted Shippers to vote on the appointment and tender.

EDF Energy would not support the GTs from being indemnified from all risks without a limited exposure to Shippers. It is general precedent within a contract to indemnify against risks and costs up to an agreed limited amount. An unlimited indemnity would not appear reasonable. We would also question why an indemnity was required? If the GTs had complied with the UNC and ensured an appropriate contract was in place then they should have no risk.

CHAPTER: Eight

Question 1: Do you agree with Ofgem's assessment that the benefits of appointing an independent third party to assess Unidentified Gas would accrue to the industry?
EDF Energy agrees that there is a benefit in implementing 0229, we also believe there is a greater benefit in implementing 0228 or 0228A as previously noted in this response.

CHAPTER: Nine

Question 1: Do you believe that a post-implementation review will be necessary for the Modification Proposals which Ofgem is minded to implement?
There may be a requirement for a post implementation review, especially if there is a significant delay between implementation of a proposal and the correct allocation of energy.

EDF Energy
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