Pricing Managers
Gas Distribution Networks

28 May 2010

Dear Gas Distribution Networks

EDF Energy Response to Distribution Networks Pricing Consultation Paper DNPC07: "LDZ System Charges Capacity Commodity Split".

EDF Energy welcomes the opportunity to respond to this consultation. We do not support implementation of the proposed methodology.

We have provided detailed comments to the specific questions asked in this consultation as an Appendix to this letter; however the key points of our response are:

- Further work needs to be undertaken to ensure Shippers are able to register an accurate AQ and SOQ for charging purposes. This was an assurance provided by the GDNs in their report on DNPC03; however no further work has been undertaken in this area.
- The GDNs have not addressed the fact that their role includes both network owner and system operator functions.
- The GDNs have not provided sufficient information to demonstrate that their shrinkage incentive costs are related to capacity bookings rather than throughput costs.
- The GDNs have failed to address the fact that when setting the shrinkage volumes as part of the GDPCR Ofgem recognised that there were throughput related issues associated with these allowances.
- This proposal should not be implemented until 1 October 2011 at the earliest to allow Shippers to build this change into their tariff structure and to address the issue of interruptible supply points.

Overall EDF Energy believes that this proposal could have benefited from further analysis and development prior to being issued for consultation. In particular we note that whilst this was briefly discussed at the January DCMF, it was expected that the GDNs would present options at the April 2010 DCMF meeting to allow Shippers to raise issues and address the merits of the options presented. However the GDNs had already raised this proposal by the April 2010 DCMF and so there was no ability to identify the additional analysis that would have been useful to support this proposal, or address the issues that Shippers have raised.

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EDF Energy's particular concerns with this proposal are as follows:

Further work needs to be undertaken to ensure Shippers are able to register an accurate AQ and SOQ for charging purposes. This was an assurance provided by the GDNs in their report on DNPC03; however no further work has been undertaken in this area.
In particular we note that under the current regime an AQ and so SOQ can take 18 months or longer to reflect a change in demand. An issue demonstrated in UNC Review Group 0177[1]. This was also an issue raised in responses to DNPC03 were it was noted that the annual review and the 20% AQ amendment tolerance in the UNC currently prevented Shippers from ensuring that an accurate AQ is registered. Whilst work has progressed in this area, in particular UNC Modification Proposals 0209, 0292 and 0293, these proposals have been raised and driven by Shippers and are not in a position to be implemented in the near future. However we note that in the DNPC03 consultation report produced by the GDNs[2] it is stated:

> "The DNs recognise that the proposed change would make it appropriate to review both the timing and size of AQ amendments and will be considering this with xoserve and the industry. The proposed timing of the methodology change would allow time for this to be considered prior to implementation."

DNPC03 was implemented with effect from 1 October 2008; however since this time not a single proposal or UNC Topic has been raised by a GDN to address this issue. Given the empty assurances made by the GDNs in DNPC03 EDF Energy believes that it would be better to implement reforms to the AQ process to ensure that an accurate AQ and SOQ is registered prior to implementation of DNPC07. We believe that this will also encourage the GDNs to ensure that the current proposals are developed and implemented in a timely manner.

The GDNs have not addressed the fact that their role includes both network owner and system operator functions.
EDF Energy would note that unlike Transmission companies the GDNs' roles and revenues are not split between Transmission Owner (TO) and System Operator (SO) functions. EDF Energy recognises that when fulfilling Transmission operator functions it is entirely appropriate to recover these revenues through capacity based charges, as the infrastructure remains in place and constant regardless of the throughput through these. However SO functions are correlated to throughput and so it is common practice for the revenues, and incentives associated with these to be recovered through a commodity based charge. We would note that NGG NTS also has a fixed allowance for shrinkage in its SO allowance and recovers this through a commodity based charge.

Whilst we recognise that the role the GDNs play as system operator is less significant than that fulfilled by National Grid, we believe that further analysis is required to identify what the GDN system operator functions, costs and revenues are in order to establish the appropriate charging

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[1] See EON presentation available at: http://www.gasgovernance.co.uk/0177/250108
[2] Available at: http://www.gasgovernance.co.uk/dnpc03

methodology. Given the approach taken by other System Operators in GB we believe that a throughput based charge would be more appropriate to recover these costs.

The GDNs have not provided sufficient information to demonstrate that their shrinkage incentive costs are related to capacity bookings rather than throughput costs.
EDF Energy would note that based on the most recent data available from the Mod 0186 reports produced by the GDNs[3] shrinkage incentive costs account for roughly 2-3% of annual allowed revenue[4]. These incentive costs are driven by the fact that the GDNs have either over or under performed against their shrinkage target. However it is not clear what has caused this over or under performance, and in particular whether this has a resulted of an improved rate of theft detection or lower throughput resulting in lower shrinkage. We believe that these issues need to be addressed to ascertain whether these incentives should be recovered through a capacity or commodity based charge.

The GDNs have failed to address the fact that when setting the shrinkage volumes as part of the GDPCR Ofgem recognised that there were throughput related issues associated with these allowances.
In particular EDF Energy would note that when setting the GDPCR for 2008-13 Ofgem issued a specific consultation on leakage volumes and incentives as a result of an error that they had identified in their leakage data et that had been used in previous consultations. As part of this consultation Ofgem note that:

> "We proposed throughput factors for the other components of shrinkage; theft of gas and own use gas."

This was to reflect the fact that at the time Ofgem recognised that these elements were related to throughput. Further when Ofgem set the fixed volumes for this target, these were developed and noted that:

> "We included varying factors across GDNs for own use gas and theft of gas, which represent around 5% of shrinkage. The GDNs have argued that it would be appropriate to include a factor of 0.031% of throughput to cover both items."

Given that at the time the GDNs were arguing in favour of a throughput related element for these costs, EDF Energy believes that this should be retained in the charging methodology. Licence Condition A5 requires the transporters to develop a charging methodology that ensures charges reflects the costs incurred on the system, and does not require the GDNs to produce a methodology that reflects their price control allowances. Whilst Ofgem may have allowed a fixed element to shrinkage costs, it would appear that if some or all of these costs are throughput related then this charging function should be retained to ensure compliance with their Licences.

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[3] Available at: http://www.gasgovernance.co.uk/dcmf/260410
[4] Based on figures provided by all the GDNs, excluding Northern Gas Networks who do not produce a separate cost for shrinkage incentives in their Mod 0186 report.

This proposal should not be implemented until 1 October 2011 at the earliest to allow Shippers to build this change into their tariff structure and to address the issue of interruptible supply points.

EDF Energy has noted on numerous occasions that Shippers require sufficient notice of any proposed change to the charging methodology to ensure that these changes are incorporated into our retail tariffs and supply contracts. We believe that a lead time of 6 months is required from Ofgem decision to implementation to provide Shippers with sufficient time to implement this change. However we note that in this instance there appears to be several benefits from delaying implementation until 1 October 2011.

In particular we note that an implementation date of 1 October 2011 would avoid the need to implement any arrangements for interruptible sites in the interim period between 1 April 2011 and 1 October 2011. From 1 October 2011 all sites connected to the distribution networks will be firm and so implementation on 1 October 2011 would avoid the need to implement a stop gap measure as proposed in DNPC07 which could have a significant impact on the costs these sites are exposed to depending on their load factor.

We also note that a 1 October 2011 would allow time for proposed changes to the AQ review process to be consulted upon and implemented, which we believe is a key development prior to the implementation of this proposal.

I hope you find these comments useful, however please contact my colleague Stefan Leedham (Stefan.leedham@edfenergy.com, 020 3126 2312) if you wish to discuss this response further.

Yours sincerely

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Appendix 1
Detailed Response to DNPC07 Questions

1. **Should the Charging Methodology be changed so that the capacity element of the LDZ System charges is set to recover 100% of the revenue from the LDZ system charges, and the commodity element is set to zero, compared with the current 95%/5% target split?**
EDF Energy does not believe that the GDNs have sufficiently demonstrated that a 100% capacity based LDZ System charge is appropriate at this time. We note that the requirement of the Licence Condition is to develop a charging methodology which results in charges which reflects the costs incurred. However the main principle of this proposal appears to be aligning the charging structure with the GDPCR allowances. This is not a relevant objective.

   EDF Energy believes that further work is required to identify:

   - The costs incurred by the GDNs as system operator. EDF Energy believes it is appropriate for these costs to be recovered from a commodity based charge, and work is required to identify what these costs are.
   - How much of shrinkage cost are related to theft of gas and own use gas. When setting the GDPCR shrinkage allowances for 2008-13 Ofgem identified that these costs were throughput related, which was supported by the GDNs at the time, and used a factor against expected throughput to develop these targets. These costs are throughput related and so it would appear appropriate to recover these from a commodity based charge.
   - Whether the shrinkage incentive costs are related to throughput or not. These are significant costs representing 2-3% of total GDN allowed revenue and it would appear appropriate for these costs to be recovered through a commodity based charge – in line with NTS arrangements.

   Further if there is to be a move to a 100% capacity based charge then the GDNs should ensure that arrangements are implemented that will allow Shippers to register an accurate AQ and SOQ. This was an undertaking by the GDNs in their DNPC03 report that they have broken. Currently there are three UNC proposals that would help to address this issue and the GDNs should ensure that one or all of these changes are implemented before making any amendments to the capacity/commodity split.

2. **Should Interruptible supply points pay 50% of the firm LDZ System capacity charge so as to maintain the value of the discount received by interruptible supply points at its current level, on average?**
Were DNPC07 to be implemented then it would appear appropriate that interruptible supply points pay 50% of the firm LDZ system charge as this will ensure that as a sector their contribution to GDN revenue remains unchanged. However we would also note that from experience with DNPC03 the impact of this proposal at site level will depend on the load factor of that site, potentially creating significant winners and losers. We believe that it would be beneficial for the GDNs to analyse what impact this proposal will have for interruptible sites connected to their system with the highest and lowest load factors. This will provide a view of the most extreme

impacts that this proposal will have, and so enable the industry to judge whether this redistribution between consumers is appropriate.

For clarity EDF Energy believes that a more appropriate solution would be to delay implementation until 1 October 2011 and so avoid this issue entirely.

3. Should this change be made with effect from 1st April 2011?

EDF Energy does not believe that this proposal should be implemented until 1 October 2011. The main argument proposed by the GDNs in favour of a 1 April 2011 implementation date is the fact that this would align with the proposed LDZ System charges restructure. However this proposal has not yet been raised or formally consulted upon, and so it is questionable whether this can be implemented by 1 April 2011 without reducing notice periods.

As previously noted in this response, and numerous other responses, EDF Energy fully supports appropriate lead times for any changes to the charging methodologies to ensure that Shippers are able to accommodate these in their tariffs and contracts. In the past we have noted that a 6 month lead time from Ofgem decision to implementation is appropriate, including instances when the costs to EDF Energy would have reduced as a result of the methodology change. We believe that this is appropriate for all changes, as otherwise Shippers will have to build risk premiums into their tariffs and contracts to cover unknown methodology changes that are implemented at short notice. This will build in costs for consumers that can easily be avoided by ensuring an appropriate notice period is followed.

EDF Energy would also note that implementation from 1 October 2011 would address the "fudge" being proposed for interruptible sites which will no longer exist post 1 October 2011; and will allow reform of the AQ and SOQ amendment process which the GDNs promised in 2007, but have still failed to deliver.