John Bradley
UNC Panel Secretary
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Dear John

EDF Energy Response to UNC Modification Proposals 0246, 0246A and 0246B: "Quarterly NTS Entry Capacity User Commitment".

EDF Energy welcomes the opportunity to respond to UNC Modification Proposals 0246, 0246A and 0246B. We support implementation of Modification Proposals 0246A and 0246B. We do not support implementation of Modification Proposal 0246. In terms of preference our preferred Modification Proposal is 0246A and our least preferred Modification Proposal is 0246.

Under the current arrangements there are two significant failures in the QSEC regime:

1. A User at a single ASEP can trigger the release of incremental capacity, but can continue to default on this capacity until it is required with no consequence. This allows Shippers to place speculative bids at an ASEP in the hope that the project goes ahead.
2. A User at an ASEP can trigger the release of incremental capacity, which results in a significant increase in allowed revenue. If the User then defaults on this capacity NGG is able to retain all of the revenues even if no costs have been incurred.

All of the modifications attempt to address the first issue by removing the loopholes and placing an incentive on Shippers not to submit speculative bids. However the second of these issues can only be resolved by Ofgem through NGG's Licence, however we believe that this needs to be addressed.

EDF Energy believes that the Final Sums Liability (FSL) regime in electricity provides sufficient protection to consumers and generators from speculative connection agreements. In particular we note that the current FSL regime is designed so that as NGE undertakes more investment the security provided by the connecting station increases so as to ensure that the industry is not exposed to unfunded investment costs should the project fail. Whilst we recognise that the link between actual investment and security has been broken in recent years due to the level of volatility in FSL, the concept remains that the industry should not have to fund the cost of project failure. However the issues in gas are more complex due to the presence of multi-party auctions. We therefore believe that the proposal to securitise 10% of QSEC bookings represents an improvements and important step forward, however further work is required in this area.

In relation to the modifications we would make the following comments:

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2. User Pays

All of the proposals have been considered as 100% Entry Capacity Shippers pay. We believe that this is appropriate on the grounds that the only benefit is felt by entry capacity Shippers in that their exposure to a defaulting entry capacity User has been reduced by the proposal. However the securitisation of entry capacity bids should not be seen as support for an automatic increase in NGG's allowed revenue.

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

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

All of these proposals address the risk of Project failure – the risk that a project is not delivered and the capacity can not be utilised creating stranded assets and a cost. However all of the proposals only reduce the risk of project failure as Shippers would remain exposed to 90% of the costs. It should be noted that in terms of company failure we believe that it is likely that the assets associated with this Shipper would have a value and be utilised by another Shipper. and so the risks faced by the industry are less. Therefore all of the proposals will have a marginal benefit to SSC A11.1 (d) in that they reduce the industry exposure to project failure.

However modification proposal 0246 proposes that only a Letter Of Credit or Deposit Deed is acceptable for securing the capacity. However we believe that this is anti-competitive and discriminatory. In particular we note that credit rating companies build up the credit worthiness of a company based on numerous factors, including risk management and general management. However these factors are ignored in 0246, this potentially provides a competitive disadvantage to Shippers with good management and risk control. Therefore 0246 does not facilitate SSCA11.1 (d). In addition 0246 will introduce additional complexity to the UNC as certain tools will be acceptable for some entry capacity commitments and exit capacity commitments, but different credit tools will be acceptable for QSEC entry capacity commitment. Complexity could be viewed as a barrier to entry and so detrimental to competition.

In addition we would note that proposal 0246B only securitises future QSEC bids. We therefore believe that whilst in the long run 0246A and 0246B will have the same effect there will be a transitionary period when 0246B is catching up. During this period we believe that 0246A will reduce Shipper exposure to project failure to a greater degree than 0246B, and so facilitates SSCA11.1 (d) to a greater extent.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer security of supply standards … are satisfied as respects the availability of gas to their domestic customers.

None of the proposals directly impact on this objective. However it is worth noting that under 0246 security is restricted to a Letter of Credit or Deposit Deed. Both of these tools will come at a cost and may prevent projects coming to the market, this may therefore have a negative impact on security of supply and so make it harder for Shippers to ensure that gas supplies are available to meet their domestic customers' requirements. 0246A and 0246B allow Shippers to make use of Parent Company Guarantees and build up an unsecured credit line based on payment history – both of these will come at a limited cost and so reduce the cost faced by new projects. They are therefore likely to have a neutral impact on security of supply and so be neutral to this relevant objective.

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.
Modification Proposal 0246 will create a situation were the credit tools for securing QSEC entry capacity are different to the credit tools that are acceptable for securing other entry capacity commitments and exit capacity commitments. This would appear to add complexity and confusion to the UNC. EDF Energy therefore believes that modification proposal 0246 will have a detrimental impact on SSCA11.1 (f). 0246A and 0246B will however ensure that the arrangements are consistent and so help facilitate this objective.

4. **The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation.**
Proposal 0246 will create a cost to all supply projects, which vary depending on the credit rating of the companies involved. This could therefore not only prevent new supplies from smaller companies coming on line as they will have to post cash to secure a Letter of Credit; but also make new supplies with a marginal NPV uneconomic for large market participants. This is particular significant in the current economic climate where the cost of credit is volatile.

0246A and 0246B allow Shippers to utilise various credit tools, with different costs. In addition 026A and 0246B allow small Shippers to reduce their cost exposure over time through a good payment history. Therefore even if these proposals introduce a cost at the start of the project there is the potential to reduce these costs in the long run. Both proposals will therefore not have as detrimental an impact on security of supply as 0246.

6. **The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal.**
In instances when NGG has seen a significant increase in its allowed revenue due to an incremental entry capacity signal which is defaulted upon and it has had to undertake limited or no physical work, then Ofgem should address this. None of these proposals should be seen as reducing NGG's risk in this area, which has highlighted a fundamental flaw in the TPCR and NGG's Licence.

8. **The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk.**
Proposals 0246A and 0246B will allow Users to use other forms of security than a Deposit Deed or Letter of Credit. It is therefore likely that the costs of these proposals will be significantly less than the £4m identified, however EDF Energy is not in a position to quantify this. Further for those Shippers who are unable to utilise a Parent Guarantee or unsecured credit limit, proposals 0246A and 0246B allow these companies to reduce their costs through a good payment history. They can therefore be seen to encourage appropriate behaviour through the timely payment of invoices and also allow companies to reduce their costs in the long run.

11. Analysis of any advantages or disadvantages of implementation of the Modification Proposal:

Advantages:

0246A and 0246B:

- Encourages timely payment of invoices to build up unsecured credit limit.

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

Yours sincerely

Seb Eyre

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