

Andrew Fox  
National Grid House  
Warwick Technology Park  
Gallows Hill  
Warwick  
CV34 6DA



23 July 2007

Dear Andrew

EDF Energy Response to: "The Entry Capacity Substitution Methodology Statement" Economic Test Consultation

EDF Energy welcomes the opportunity to respond to the consultation on the economic test associated with the substitution of entry capacity between ASEPs. We believe that option 1, maintaining the current NPV test remains the appropriate test against which investment signals are judged for this September's QSEC auction.

However, we remain concerned with the processes that have been followed in reaching this position. It would appear that the numerous revisions to entry capacity arrangements currently being witnessed are being driven by the sudden changes to baselines during the TPCR process and the implementation of the current entry regime several years ago. The unexpected decrease in baseline capacity at Teesside as part of the TPCR, for example, threatens to render some of the new infrastructure at this ASEP stranded, whilst the incentives on NGG ensure that capacity is not delivered even when they know it will be required if the auction signals are not present. We believe that the dramatic decrease in baselines could have been mitigated by ensuring a transparent process was followed with sufficient lead time for Users to mitigate against these actions. However we would also question whether the plethora of activity currently seen on entry is the most appropriate way to resolve these issues, and whether Ofgem's comments on discretionary capacity release at the end of their recent IECR decision will have a negative impact on the UK's security of supply and customers.

It would appear that one of the main benefits of the previous entry regime was that NGG had the discretion as to whether to release incremental capacity even if the auction signals were not present, to ensure that sufficient capacity was available to meet the UK's security of supply requirements. However in Ofgem's IECR decision letter<sup>1</sup> they suggest that any incremental capacity that is released on a discretionary basis could be viewed as discriminatory, not in line with their licence conditions, and likely to be viewed as inefficient and therefore unlikely to be funded. By constraining NGG in this manner the UK's security of

<sup>1</sup> Ofgem ref 182/07, published 16 July 2007

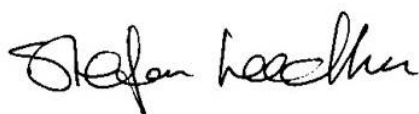
supply could be threatened as a result of miscalculations and oversight, resulting in higher prices to customers. Combined with the recent baseline alterations we believe that this is creating significant financial and regulatory risk to Users that is making the UK a less attractive source for gas to be delivered. However due to the long lead times associated with this, the impact will not be felt for several years.

Whilst we support the use of the current NPV test, EDF Energy is concerned of the impact that having this test in place for this September's QSEC auction only will have on the investment signals that will be provided from these auctions. In particular we note that this will create significant regulatory uncertainty for Users who may be considering providing investment signals through this auction. Whilst the proposal is the simplest and most transparent for implementation prior to September, the fact that it is likely to change, again, may discourage Users from providing investment signals if they believed that entering this auction process would represent a commercial disadvantage compared to entering the process next year. This could further threaten the UK's security of supply position at a cost to consumers.

Given the uncertainty and risk that this proposal, and the procedures adopted, now represent we therefore believe that it may be beneficial to delay implementation of the substitution regime until next year. This will allow the industry to develop robust procedures that will allow the QSEC auctions to operate as intended, and should not provide any perverse or unexpected impacts.

I hope you find these comments useful, however please contact me should you wish to discuss further.

Yours sincerely

A handwritten signature in black ink that reads "Stefan Leedham".

Stefan Leedham  
Gas Market Analyst  
Energy Regulation, Energy Branch