

Sonia Brown
Director, Transportation
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

9 March 2005

**GAZ DE FRANCE ESS (UK)
LTD**

1 City Walk
Leeds
LS11 9DX
United Kingdom

tel: +44 (0)113 306 2000
fax: +44 (0)113 245 1515

www.gazdefrance.co.uk

REGISTERED IN ENGLAND
NO. 2706333

Dear Sonia,

Gas de France ESS response to:
National Grid Transco – Potential Sale of gas distribution network
businesses
Initial thoughts on enduring incentive schemes supporting the offtake
arrangements

Introduction

Gaz de France ESS is a major supplier committed to bringing business energy excellence to the UK gas and electricity supply markets. Gaz de France ESS currently enjoys a 12% share of the Industrial & Commercial Gas supply market and over 5% of the Industrial & Commercial Electricity supply market and is currently the 5th largest supplier to the combined Industrial & Commercial UK Market.

Gaz de France ESS is focussed on providing customer service excellence to our target market of Industrial & Commercial gas and electricity users and has a range of innovative products and services designed to cater for both large and small consumers in these sectors.

Outline and summary of points

Thank you for the opportunity to comment on these proposals. To clarify our position, Gaz de France ESS are not supportive of the exit arrangements as currently drafted for reasons previously stated in our response to OFGEM's impact assessment consultation. We believe they are unduly complex and unnecessary to facilitate the sale of Gas Distribution Networks. We would however like to take the opportunity to comment on the details contained in this consultation, particularly three key areas; Interruption arrangements, baseline quantities and NTS enduring incentives.

- **Interruptions arrangements for NTS direct connects**

The arrangements in place for gas interruptions for NTS direct connects have a significant impact on very large end-user consumers and gas fired electricity generation plant. Under the enduring arrangements as drafted, the NTS will only offer an interruptible product at day-ahead stage. The

uncertainty associated with this approach from an end-user perspective is significant and undesirable.

In this environment, a conservative and understandable reaction for a site which is currently NTS interruptible would be to fear not having the ability to flow gas for a sustained period in the future and may opt for firm capacity and book via the auction regime. This will have several effects, firstly to increase costs of operation for the consumer or generator who now has to pay for firm exit capacity rather than bearing the more acceptable risk of limited interruption under the current regime. The cost of this peace of mind will be significant and cause pain to end-user businesses by making them uncompetitive.

Also, increased costs to a gas fired generator are likely to be transferred to the wholesale electricity market and inevitably manifest themselves to end consumers in higher prices. Does this meet OFGEM's objectives to protect customers ?

Other potential impacts of a dash for firm, depending on the baseline allocation decided upon, could result in significant revenue over-recovery by Transco NTS where incremental investment has not been made. The significant response that interruptibles currently offer to support constraints on the NTS could be reduced considerably under this regime leading to inefficient infrastructure investment taking place.

The reduced presence of interruptible offtakes on the NTS also has implications for security of supply in periods of system stress because proposed demand management services on the supply side are as yet untried.

NTS users who prefer to remain interruptible under the enduring regime face unprecedented risks over their ability to flow gas, exit capacity may not be available in the short term, or worse may have been transferred under the exchange rate transfer mechanism for longer periods leaving the end-user stranded.

In conclusion with regard to interruption arrangements, additional consideration should be given to ensure there is a long-term interruptible product available to allay customer concerns and protect their interests and the associated interests of system efficiency and responsiveness. Day-ahead interruptible products alone are insufficient to address the market's needs.

Baseline Quantities

Whilst we cannot state a clear preference for a specific option at this moment in time until we can understand the operation of the buy back fund more clearly, option b ;forecast 1 in 20 firm demand plus interruptible or option c ; practical maximum physical capacity seem to be the more preferable options as they better reflect the capability of the system and customer requirements.

a) Forecast 1 in 20 firm demand

The implications of this option under a constrained only release scheme, mean that there will be no release of interruptible exit capacity even at day-ahead stage. Existing interruptible sites will have a zero allocation and be subject to bidding for incremental firm capacity at a price yet to be determined. This seems an unpalatable option from a customer perspective due to additional costs and an uncertain provision of capacity. This option may result in clear investment signals to Transco but could result in uneconomic over-investment in the system and unnecessary costs to end-users.

b) Forecast 1 in 20 firm demand plus interruptible demand

This arrangement would fully meet the needs of customers, both firm and interruptible on the system at the moment by effectively securing their SOQs. Interruptible capacity could be released up to the constrained level albeit on a day-ahead basis, but the potential remains for exit capacity to be eroded from an offtake by the capacity transfer mechanism.

c) Practical maximum physical demand

Providing that the practical maximum physical capacity includes current interruptible capacity offtakes, this approach meets the needs of customers in a similar way to option b above. This approach as near as possible matches the current capability of the system and as such seems to be a reasonable level at which to set baselines.

d) Theoretical maximum physical capacity

This does not seem to be a feasible option as nodal offtakes cannot be considered in isolation, the practical flow of gas on the system must be taken account of. This is a potentially dangerous level at which to set baselines and incremental capacity signals should be actioned ahead of this.

Enduring Incentive schemes

Gaz de France ESS fully agree with the principles outlined in this document :

- To ensure that the NTS has incentives to deliver the full physical capability of the network.
- To ensure that the NTS has sufficient funds within the price control period to undertake appropriate incremental investment in line with demand signals
- To ensure that the NTS has an incentive to buy back NTS offtake rights in order to relieve network constraints in an efficient and economic manner.

The principle of substitution looks efficient in theory but it is very worrying in practice. The transfer of exit capacity from adjacent offtakes is something which is efficient if this evolves over time and does not prejudice end-consumers from taking gas. Under these arrangements however the transfer

of exit capacity can happen all too easily as a result of a single set of auctions and could leave end-consumers unable to flow gas. This is an unacceptable penalty to impose on businesses who may be ignorant of the detail of these proposals. This is a brand new regime and at the very least needs to address the fact that there will be teething problems.

No-one is in possession of perfect information 3years ahead of time and further consideration needs to be given to the concept of substitution. The objective to operate an efficient system is valid and customers should be allowed to benefit from this, however if this is at the expense of consumers' right to flow gas then these benefits become absurd

I trust this information is helpful and if you have any questions or would like to discuss further, please do not hesitate to contact Phil Broom, Regulatory Affairs Analyst, on 0113 306 2104.

Yours sincerely

Phil Broom
Regulatory Affairs Analyst
Gaz de France ESS