

Joanna Whittington
Director Gas Distribution
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

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**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 Joanna,

**Gas de France ESS response to:
“Initial thoughts on the reform of interruptible arrangements on gas
distribution networks”**

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.

Thank you for the opportunity to respond to this consultation. Gaz de France ESS have a particular interest in any proposed changes to these arrangements as we are one of the largest suppliers to Industrial and Commercial customers having “Interruptible” transportation terms on the Distribution Networks. Please find our comments and answers to your consultation questions (where possible below). We trust that these comments will help inform the structure and content of the resulting Impact Assessment:

Section 2 – Principles for Reform

Has OFGEM identified the key weaknesses of the current interruption arrangements for the GDNs?

Customer choice and switching

Under the current regime customers have a degree of choice whether they remain firm or switch to interruptible arrangements. A key concern of OFGEM in the consultation seems to be the lack of control of GDNs over the amount, and location of interruptible capacity. The principle of customer choice seems to have been lost here and skewed towards GDN control. Our experience proves that the decision to switch from firm to interruptible is not one that is taken lightly by customers due to the significant contingency planning needed to respond. Even though the current regime offers flexibility to be able to switch year on year between firm and interruptible status, this is something that we rarely see. Most decisions are taken with a medium/long term view in

this respect and as such should not hinder investment decisions taken by GDNs within a price control horizon.

Indeed, in light of recent experience there are good investment signals to be seen under the current regime. Recent evidence suggests that many supply points are moving away from interruptible to firm status without the need for a costly reform of market arrangements. The economic benefit from being interruptible has been eroded over recent years as the interruptible discount relative to final prices has reduced.

To illustrate this, when the case for reform of interruption arrangements was first raised in the review of Transco's System Operator Incentives in 2001, transportation (and metering) costs for a typical interruptible customer accounted for approximately 11% of final price. An identical supply point now has seen gas prices three times that of 2001 and as a result transportation costs account for less than 4% of the final price.

This, combined with the high cost of alternative fuel has signalled that the risk/benefit balance of interruptible transportation arrangements has diminished and caused many customers to review their terms. This is a clear signal that the perceived cross-subsidy between firm/interruptible is reduced if not negligible at present.

Distributional impact of current arrangements

Increasing the ratio of capacity compared to commodity for transportation charges is a principle supported by Gaz de France ESS as highlighted in our response to the OFGEM consultation on the review of the structure of gas distribution charges. An increased capacity ratio more accurately reflects the true costs of providing gas distribution networks and helps to smooth prices by reducing the variation caused by commodity charging. We believe that this defect in the current charging arrangements should be addressed as soon as possible. However, any reforms to interruption arrangements should be carefully considered before implementation and certainly should not take effect before 2010 as proposed.

De-linking Capacity/Commodity split and Interruptions reform

Gaz de France ESS recognise that the redistribution of costs between interruptible and firm supply points would be exacerbated if the charging arrangements were changed ahead of reform of interruption arrangements. However, we believe it is possible to de-link these issues to allow for more cost reflective charging to be applied sooner.

If a higher capacity to commodity ratio were introduced to DN charging earlier than interruptions reform then transitional arrangements could be developed to mitigate the increased distribution effect. For example, a discount factor could be calculated for interruptible supply points and this could be applied instead of the current full exemption from LDZ capacity charges. In this way Interruptible supply points could retain their status for the transitional period. This would also re-balance any unintended skewing of distribution effects ahead of any reform of interruption arrangements.

To what extent do interested parties consider the current arrangements have significant strengths, and if so, what are these strengths?

Under the current regime Interruptible supply points offer significant volumes of capacity and demand reduction when required in stage 1 of a Gas Supply Emergency. A move towards a world of “universal firm” would shift significant volumes (circa 40mcm/day) from stage 1 of an emergency to stage 3 Firm Load Shedding. In many ways, under the current construction of the emergency escalation procedure, those supply points on interruptible arrangements provide a valuable buffer before firm load shedding occurs.

A move away from the current regime may have a discriminatory impact against those supply points that were previously classed as interruptible. These may be deemed more interruptible than identically priced firm supply points for legacy reasons and could unfairly remain above other firm sites in the list for involuntary interruption.

The current arrangements, which although could be described as inflexible, do encourage an efficient system where adequate interruptible capacity is offered thus protecting against over-investment. A baseline/incremental investment approach could result in lumpy investment in future, which may in turn result in increased headroom and a less efficient system.

Do you agree with Ofgem’s key principles for reform?

Gaz de France ESS can see some merit in the arguments suggested for reform, namely, dispensing with the “one size fits all” concept via an increased range of products may better harmonise customer and GDN requirements.

It is inevitable however that regime change will incur additional costs on participants, particularly the administration costs of shippers in this case and this may hinder competition. Additional costs and/or systems may discourage suppliers from competing in these markets, which may reduce customer choice and overall competitiveness.

Section 3 – Implementing Reform

To what extent do respondents consider that the model so far developed by the GDNs meets Ofgem’s principles for reform?

Should reform of the regime be progressed, Gaz de France ESS believe that it is imperative for GDNs to develop a single uniform model to apply to all DN networks. Any model developed should avoid unnecessary complexity to help reduce the cost impact on shipper processes and systems. As yet, initial proposals from GDNs have been high level and these lack sufficient detail to be able to comment in depth at this stage.

The initial proposals suggest a 3year lead time by which shippers submit interruption offers to GDNs on behalf of customers. It is rare for a shipper to the Industrial and Commercial market to contract for supply this far ahead; generally this is a very competitive market which is dominated in the main by

12 month supply contracts. Interruption options should stay with the customer to prevent any detrimental impact on competition and a robust transfer mechanism should be critical to the development if a regime change is determined to be necessary.

The proposed matrix approach has the advantage of offering product flexibility, which as stated before could harmonise customer and GDN requirements. It seems reasonable to reimburse the “option fee” element of successful bids as a discount off capacity, calculated on an annual basis. There is the possibility that the amount of registered capacity could change up or down within any capacity year and therefore we would recommend an adjustment mechanism is in place to reconcile this for participating supply points.

In the event that a GDN’s interruption requirements have not been met it is appropriate that additional tenders may be contracted at a later stage.

Has Ofgem identified all the key interactions with the enduring offtake reforms for the NTS?

There is a clear link between the timing of identifying requirements for firm capacity on distribution networks and the need for GDNs to book NTS exit capacity. An early indication as to the baseline requirement for firm capacity calculated for each GDN should be available to shippers and customers in order to determine the extent to which Interruption services are required. An indicative view of GDN requirements should also be available to inform the forthcoming Impact Assessment.

Conclusion

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

Yours sincerely



Phil Broom
Regulatory Affairs Analyst
Gaz de France ESS