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REGISTERED IN ENGLAND
NO. 2706333

28 August 2007

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Response to DNPC03 LDZ system charges – Capacity/Commodity split and interruptible discounts

a) **Should the charging methodology be changed to so that the capacity element of the LDZ system charges are set to recover around 95% of the revenue from the LDZ system charges, and the commodity element is set to recover 5% of the revenue compared with the current 50/50 target split?**

Gaz de France ESS is generally supportive in principle of the proposed change in methodology to a 95:5 capacity commodity split for LDZ charges; however there are also consequential impacts which need to be considered.

Cost Reflectivity and redistribution effects
It is a licence objective for transporters to recover their costs in a cost reflective manner and in a way which facilitates competition between suppliers. The evidence presented in the consultation paper suggests that around 95 % of Distribution Network's costs are fixed. Reflecting these fixed costs via fixed capacity charges fits with the principle of cost reflective charging. This also indicates that under current charging methodology there is a cross-subsidy in favour of low load factor sites. A move to the proposed methodology would remove this cross-subsidy and better facilitate competition through cost reflective charging.

Supply Contracts

Stability of transportation charges year on year is important for suppliers and customers alike when setting fixed contract prices which span charging years as this reduces the risk associated with such contracts. Also, for suppliers who offer pass through transportation charges to their customers, reconciliation amounts, either during or at the end of a contract are less significant and therefore pose less risk.
However, one aspect to consider here is wherever suppliers recover their revenue on a unit rate basis then additional fixed costs will not be recovered should the customer under consume against forecast volumes. This may have the effect of increasing risk premium or additional end of contract reconciliation between suppliers and customers.

Additional Modelling Required
To date there has been little supporting evidence produced by the DNs to justify the assumption that charges would become less volatile under the proposed model. Gaz de France ESS would like to see the following analysis presented to support the claim of decreased volatility from the proposed Capacity/Commodity split:

1. Retrofit the 95:5 model individually to previous year's charges for each DN or LDZ as appropriate

2. Retrofit a smoothing model which smoothed DN charges over a rolling 3,4,5 years with the current 50:50 split

3. Retrofit the 95:5 model combined with a smoothing model as described in 2. above to see the combined effect of models 1 and 2.

The above analysis should better inform the decision making process as the true value of each model could be assessed against viable alternatives.

b) Should Interruptible Supply Points pay 47.37% of the LDZ Capacity charge so as to maintain the value of the discount received by interruptible supply points at its current level, on average?

Gaz de France ESS considers that maintaining the overall discount for Interruptible sites is fair. This proposal does however introduce the concept of LDZ capacity charges being levied on interruptible customers for the first time. This can be considered an appropriate interim solution before the implementation of mod 90 in 2011 and introduces interruptible customers partially to the universal firm and sell-back regime.

There are however operational difficulties faced by suppliers both in terms of systems and charging but also with regard to customer education. We would expect the education process to be mainly conducted by suppliers but with significant support from Distribution Networks by means of supporting documentation and also by briefings at relevant forums e.g. customer operations forum and via ad-hoc requests from suppliers.

Appendix 1 – Average impact of proposed changes

We believe the indicative load factors shown in appendix 1 illustrate a need for a thorough review of DMSOQ data held by shippers and transporters. We have compared data from our own load forecasts which suggests that load factors for interruptible sites should closely resemble that of firm sites in each particular Load Band. This is clearly not the case as many load factors for interruptible sites in appendix 1 appear exceptionally low and manifestly different to that of similar sized firm sites. In many cases the indicative load factors are below that of a domestic heating load site, this seems intuitively wrong.

One possible reason for this error could be the relatively poor quality of DMSOQ data for interruptible sites. As currently the DMSOQ for an interruptible site is largely irrelevant for charging purposes these may not have been reviewed as thoroughly as equivalent firm sites and the quality of data held may have drifted over time. Should interruptible sites face an LDZ capacity charge for the first time under these proposals then there needs to be time and resources allocated to a thorough review of this data before implementation and charging.

c) Should this change be made with effect from 1 April 2008 or 1 October 2008?

From the alternatives available in this consultation Gaz de France ESS prefers an implementation date of 1 October2008. As detailed above under our response to a), many supply contracts already extend past April 2008 and because of their forward reaching nature have not been structured to take account of these proposals. Suppliers need appropriate lead time to factor in significant changes such as these into their terms with customers; this should be achievable for the majority of supply contracts should implementation take place in October 2008.

Also, as mentioned in point b) above, there needs to be a wholesale review of DMSOQs for interruptible supply points before implementing charges on this basis. The resulting improved data accuracy from this review would benefit Transporters, Suppliers and Customers alike but as above it is not achievable before April 2008.

I trust these comments are helpful, if you have any queries regarding this response please contact me on 0113 306 2104.

Yours sincerely

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