Gaz de France

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<u>Gaz de France ESS response to:</u>
<u>Interruptible charging methodology options for UNC Modification Proposal 0090</u>

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 is a leading supplier to the interruptible market segment.

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.

Question 1 – Which of the 3 main approaches is favoured?

An open tender process is our preferred option. Should there be a significant regime change as proposed then it is important to maximise the benefits of change for consumers, both those requiring to sell back interruption rights to their gas network and those choosing to remain firm. This approach allows consumers and shippers to discover and realise the true cost of interruption for those that participate successfully and allows for efficient networks to minimise costs for those who remain firm.

This is the only one of the 3 stated options that meets the objective of reform to "enable shippers to place a value on the interruption they provide". Views have been expressed that a more complex tender process may be a disincentive for some groups of consumers to participate via bids, this is not necessarily the case; there is an opportunity for shippers to assist the tender process and provide added value services to their customers. An open tender approach should provide an incentive for shippers and suppliers to develop innovative products and services, which would enhance competition in supply.

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Conversely, administered prices do not allow for price discovery and may not reflect true costs for consumers. There is a risk with fixing the price that administered prices can lead to inefficient outcomes. In the scenario where DNs set the price for interruptible contracts slightly below the annualised cost of incremental investment this may be higher than the price at which a consumer may bid in via a tender approach. It can be argued that an administered price does not improve much from the current regime where a capacity discount is offered, this option does not allow the true cost of interruption to be discovered and does not offer the stated benefits of reform as fully as the open tender approach.

The hybrid approach, as with administered prices does not give the opportunity for shippers/consumers to place a value on the interruption they provide. By setting a cap price this effectively is as potentially inefficient in a similar way to the administered price option discussed above and will either encourage clustering of prices around the cap or pricing at the cap where there are few interruptible bids in a particular zone.

Additional Comments:

Gaz de France ESS would however like to see improvements made to these proposals to provide reasonable incentives to participate for shippers and consumers. As currently drafted the proposals do not allow for recovery of costs for at least 3 years after contracts have been finalised, it is unreasonable that shippers and consumers should face a cash-flow burden on behalf of DNs and we would encourage a portion of the option fee element to be paid on completion of contracts.

If there are not appropriate incentives in place for shippers and consumers to bid in for interruption services this could result in some zones contracting below required levels. Investing out of this by DNs could be less efficient than prices otherwise achieved via contracts and perhaps more importantly this could expose DNs to delay risks associated with the plan and build of pipelines to support a more firm network.

Whilst capturing the right tender based approach we would encourage the tender documentation itself to be understandable and straightforward to complete. It is likely that there will be a limited amount of time for validation by shippers and DNs and a clear process would provide a practical incentive for participation in tenders.

Question 2 – Given that shippers/consumers will need to determine their own value for interruptible rights to some extent under all approaches, are the shippers/consumers costs for the tendered price approaches significantly greater than for the administered price approach?

Of all the options listed the least cost option for shippers and consumers would be an administered price. Firstly, the setting of administered prices places more of the cost burden on the Distribution Networks themselves, however the cost of price discovery is placed more directly with consumers and shippers under the open tender approach. Overall costs for price discovery, be it for transporters or consumers/shippers may be similar at both ends of the scale, especially if costs for consumers and shippers are reflected in the tendered bids.

Secondly, the costs for consumers and shippers who undertake an assessment exercise prior to bidding may not be dissimilar under an administered price or tender model. If prices are set by DNs then a consumer in a particular zone will have to benchmark the administered price against it's own costs before assessing whether it is feasible to pursue an interruptible arrangement. Additional incremental costs may be incurred for consumers with the tender approach but these may not vary significantly from those under other options.

Tendered price approaches are costly to administer for shippers but may only be incurred on a 5yr cycle (see Q6). This reinforces the requirement for incentives at point of sale for consumers/shippers as explained in Q1 additional comments.

Question 3 – The varying level of operational requirements and competition for interruptible rights in some zones could lead to greatly differing levels of price achieved for interruption rights in different zones, is this seen as a potential drawback or as an appropriate outcome?

Prices achieved in zones will inevitably vary under any option, administered prices or tender, but may be less efficient under an administered price as discussed in Q1. This is an appropriate outcome from a cost reflective regime and the contracting costs for interruptible rights will always be assessed against the annualised cost of investment to achieve efficiency.

Question 4 – What are respondents preferences for the strucuture of the option and exercise scheme outlines in section 6?

Our preference here is to strike the right balance between customer choice and simplicity. We believe a range of around 4 combinations of option exercise fee split should be adequate to accommodate a range of differing consumer requirements.

It is likely that there could be a more biased weighting towards option fee element as bidders seek to minimise risk of not recovering costs. A stronger weighting towards option fees also better reflects the high proportion of fixed cost associated with investment in alternative fuel switching equipment. Variable cost elements may be limited mainly to the differential in gas to distillate prices.

Question 5 – To what extent does the frequency of purchases of interruption rights impact on the decision about the method chosen to purchase them?

There should be a natural alignment of interests toward longer duration of contracting both from consumers/shippers and Distribution Networks. Contracting for a five-year duration gives certainty and stability for Distribution Networks and this certainty should be reflected in the price that Networks are prepared to pay for longer-term contracts. Likewise, consumers are unlikely to choose to flip between firm and interruptible status with investment decisions generally assessed in the long term in both cases.

A five-year cycle of major contracting rounds is a likely outcome with the ability to tweak for residual requirements in the shorter term. This should reduce the cost burden for consumers/shippers and Distribution Networks compared to a full annual tender round each year and therefore getting it right via a full tender approach seems to be justified on this basis also.

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

Yours sincerely

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