Gaz de France

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Dear Sonia,

**Gas de France ESS response to:**
**National Grid Transco – Potential Sale of gas distribution network businesses**

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 5$^{th}$ 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.

**Gaz de France ESS view and summary of points**

Given the uncertainty of current proposals for framework arrangements, as a prudent Shipper/Supplier, Gaz de France ESS is currently in favour of the **No Sale option.** We do not have sufficient confidence that the program as currently structured will deliver significant benefits to our customers or create a more efficient regime for gas transportation.

At this point in time it is difficult to assess the full impact of proposals, however, given the enormity of the impact on the industry of the sale of gas distribution networks, we do not believe that there has been satisfactory consideration or consultation and we have a number of concerns in key areas. In order to justify our position and help OFGEM identify areas for further consideration, we have the following comments:

- **Exit Reform Arrangements and Products**

Whilst we recognise the need to achieve more definition and clarity with regard to NTS exit arrangements, there are a number of flaws already apparent within the current proposals, which gives us little confidence for success. We would be happy to work with Transco, OFGEM and other Shippers to develop a more practicable set of arrangements.

The concept of an auction regime for exit capacity modelled on that of entry capacity seems to create an artificial market. There are distinct differences between the two; there is logic behind an auction regime for entry capacity as entry points naturally have a number of market participants for the service and market principles seem sensible here, whereas with exit capacity there is likely to be only a single incumbent bidder for the service, be it a DNO or Shipper. Is an auction regime the most efficient process for what is naturally a tightly constrained market?

The proposed auction regime for exit capacity discriminates unduly between DNOs and Shippers. Under current proposals Shippers can compete for capacity at non-DNO off-takes but bidding at DNO off-takes is constrained to relevant DNOs only. If the purpose of the auction regime is to deliver a traded product at a market determined price then the arrangements need to reflect this by ensuring equitable access to capacity.

Another concern is whether exit capacity, tradable across nodes, is the best way to give Transco proper investment signals that deliver a clearer view than the current planning approach. The proposed matrix of exchange rates (which has yet to be developed) does not give confidence that arbitrage opportunities may exist, leading to inefficient signals to Transco in long-term unconstrained exit capacity auctions.

In the case of long-term unconstrained release of capacity there is clearly a risk of inappropriate cost allocation in respect of new investment. It is possible that the current incumbent Shipper holding constrained capacity could be outbid at auction and subjected to much higher costs associated with unconstrained capacity development which may be physically required by a competitor at that off-take point. Any additional costs will ultimately be bourne by customers.

Flow-Flexibility is clearly a stand-alone product over and above exit capacity release as described above and this product is not crucial to delivering more transparent exit arrangements. The flow-flexibility product is currently unnecessary as the inherent flexibility on the system can cope with almost all requests for additional flexibility without putting the system under undue stress.

The interim arrangements proposed in relation to flow-flexibility seem to fit well with a low cost enduring solution without the need for immediate complication. We would suggest a periodic review of flexibility to be the most sensible way to identify future concerns. We are concerned that there is no cost benefit justification for this product and that there are further complications regarding identifying an equitable baseline for inherent flexibility, risk of Transco over-recovery and Shipper cost recovery mechanism.

- **Security of Supply**

  We have a serious concern around the implications around security of supply with regard to the flexibility product for both gas and electricity. In the gas market, storage providers and Shippers flowing gas from storage may be subject to penal flow rate charges and be incentivised not to flow gas when end-users need it most.

  There seems to be a significant threat to security of supply in the electricity market where CCGT plant which are, under current rules one of the most flexible providers of power to the balancing mechanism, disincentivised from increasing output in the proposed world of flow-flexibility. This may have a serious impact on the liquidity of the electricity Balancing Mechanism and lead to more pronounced price spikes.

  Also, in the case of CCGT plant, there is the possibility of the erosion of exit capacity over a period of time due to exit capacity being efficiently booked below maximum. In critical conditions plant could be constrained on the gas side from generating at full capacity to meet peak electricity demand.

- **Benefits Case and Shipper Costs**

  The cost estimates originally submitted by Shippers were a best estimate of costs based on proposals at that time and are likely to be understated given current information. Having had some more information revealed (although not yet complete) it would seem fair and an appropriate time to allow Shippers to review these estimates of cost. The flow flexibility product in particular would seem to add a disproportionate level of costs compared to benefits. Other factors, which have subsequently become a concern, are costs of new credit arrangements and credit overlap, further impacts on shipper systems together with the need for additional operational resources resulting from the more complex set of arrangements currently proposed.

  The key driver for benefits contained in the Impact Assessment is clearly that attributed to comparative regulation (95% of benefits). Firstly, it seems impossible to argue a reasonable cost/benefit case for the remaining 5% of benefits being attributed to proposed new exit arrangements and flow-flexibility, as these constitute the majority of shipper costs. Secondly, it is important to understand whether the benefits identified are in addition to, or inclusive of, potential savings identified by OFGEM when previously setting out the case for separate Price Controls for NTS/Distribution Networks? Further clarification would be appreciated as a significant proportion of the cost to Shippers could be excluded in the No DN Sale scenario.

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- **Customer Concerns**

  The additional complexity that will be introduced by the proposed exit arrangements and associated products is unwanted by customers and is seen to be an unnecessary complication for their business. A large customer directly connected to the NTS is unlikely to be able to forecast its long term capacity requirements to such an extent that it can effectively commit to an auction regime via its current shipper. Moreover, there is a distinct difference between the commercial drivers for loads directly connected to the NTS, which is not differentiated in current proposals. Where in the case of a CCGT long-term contracts and shipping arrangements are more commonly in place, this is unlikely for large customers who are encouraged to change shipper frequently for commercial reasons. It is unpalatable for customers to have even more risk to their business and budgets by being uncertain of future costs associated with an auction and secondary market regime, and further costs introduced by within day flow penalties.

  A further concern here as a shipper acting on behalf of NTS Directly Connected customers is the level of advice/interaction/information we are restricted to giving customers as a result of FSA legislation.

  Is it in the interests of customers to introduce a more complex regime, which represents a significant barrier to entry to potential new market entrants who may otherwise have increased competition in supply ? Also, the significant costs associated with new exit arrangements and flow-flexibility products are disproportionately large for smaller Shippers, those currently in the market may decide to exit.

In addition to the above points on regime change, we have further concerns around process, governance and timescales as detailed below:

- **Due Process and Governance**

  The process for governance and consultation on this matter has been taken outside of the due process of the Network Code. The majority of Transco proposals for the interim and enduring regime relating to the world of post-Network Sale have taken place at newly formed groups such as the Exit Reform Group and Development and Implementation Steering Group, which have no formal standing under the Network Code. Consideration of such matters should be governed under already established workgroups, which report into the Network Code panel where proposals can be given formal consideration.

  Raising a series of modifications through the established Network Code route would ensure that proper and thorough consideration was given to the significant changes being proposed, by Shippers and interested parties. The current proposal for one single “take it or leave it” modification associated with the move to the Uniform Network Code sets an unwarranted precedent and is unacceptable.

- **Timescales**

  The current timetable for development, communication and implementation are unrealistic for changes of this magnitude, and we believe there is a significant risk of oversight and business risk associated with the planned timescales. Changes of this magnitude deserve to be assessed properly by Shippers and industry participants and the pace of change to date has been alarming. Participation by Shippers can only be limited due to finite resources and there is a significant risk of oversight, which may lead to flawed arrangements being accepted if proposals are progressed hastily. There is currently insufficient information available to Shippers to have confidence in these proposals.

  Crucial information regarding exit arrangements and products are not available at time of writing including; baseline quantities for capacity, matrix of nodal exchange rates and indicative auction floor prices. Additionally, there has been little information regarding the incentives regime or the comparitor mechanism for Retained Distribution Network Owners and Independent Distribution Network Owners, which give rise to almost all the stated benefits to customers.

In conclusion, for the reasons outlined above, we are not currently in favour of the sale option.

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

**Barbara Vest**
**Regulatory Affairs Manager**
**Gaz de France ESS**