

Summary of answers to the public consultation on pricing principles for use of natural gas distribution networks in France

Between 9 October 2007 and 9 November 2007, CRE organised a public consultation on the pricing principles for use of natural gas distribution networks in France, in preparation for a new tariff proposal, to be applied as from 1 July 2008.

CRE received 26 contributions (see list in the appendix):

- 1 from an end consumer,
- 10 from suppliers,
- 9 from natural gas distribution system operators (DSO),
- 2 from natural gas transmission system operators (TSO),
- 1 from potential users of natural gas distribution networks (Club Biogaz),
- 1 from an energy syndicate,
- 1 from the AFG,
- 1 from the FNCCR.

This consultation showed that most contributors were satisfied with the existing tariffs and the conditions governing the use of distribution networks, even if attention was drawn to some operational difficulties.

Furthermore, the majority of market players were in favour of the following propositions:

- setting up an incentive scheme to promote productivity and quality of service,
- setting up a correction mechanism – the expenses and revenues clawback account (CRCP); opinions were more divided as to the integration of the volume risk in this mechanism, which might lead to significant assets and liabilities in the CRCP,
- extending the existing tariff structure to new concessions,
- taking into account costs incurred in promoting the use of gas and the safety of indoor installations (although there was a narrower majority among suppliers on this point),
- changing the way losses and differences are processed for GrDF and taking them into account in the CRCP,
- aligning the scope of services included in the tariffs charged for the use of distribution networks.

However, the contributors, especially the suppliers, were against the proposal to leave tariffs for new concessions to the discretion of DSOs.

Opinions were divided on:

- the validity period of future tariffs, although a large majority of suppliers stated that a long term visibility on tariffs was required,
- transferring to TSOs the cost of adapting delivery stations at transmission distribution interface points (PITD) and ensuring their compliance,
- achieving a rebalance between the fixed parts and proportional terms of tariff options.

Lastly, many suppliers pointed out the need to ensure that the tariffs for the use of distribution networks and the regulated retail tariffs for natural gas were mutually consistent, not only in terms of level, to avoid unfair competition between suppliers, but also in terms of structure, to avoid cross-subsidies between customer segments.

## **PRELIMINARY QUESTION:**

**Question 1:** *What is your experience feedback on current tariffs and terms for the use of natural gas distribution networks?*

### **Suppliers and end consumers:**

As far as tariffs are concerned, most contributors claimed to be satisfied with current terms for the use of distribution networks. They wished to maintain existing principles and leave the tariff structure unchanged.

One supplier stated that tariffs were high, especially in comparison with other European countries.

Another supplier regretted the great disparity in prices from one DSO to another and hoped that future tariffs would attenuate these differences.

Three suppliers pointed out the need for greater consistency between the tariffs charged for the use of distribution networks and the regulated retail tariffs for natural gas. One said that the changes in infrastructure tariffs should be passed on to the regulated retail tariffs for natural gas as soon as possible. Others expressed concern about the lack of consistency between the regulated tariffs schedule and transportation tariffs.

The contributors raised other points that were unrelated to tariffs. Two suppliers reported operational problems with GrDF, including difficulties in obtaining information vital for making an eligible bid and for billing (number of metering and estimation points, metering data, etc.), problems relating to daily allocations (data on D+1 frequently inaccurate, etc.) and access to the new OMEGA portal. Lastly, one market player regretted that GrDF was sometimes too rigid in its application of the procedures defined during gas working group meetings (GTG).

### **DSOs:**

None of the DSOs reported any particular difficulties or made any suggestions for improvements regarding the tariffs structure and their implementation. In fact, one DSO pointed out that the data on customers and market players gathered via various channels (regular satisfaction surveys, bilateral meetings and the activities of the gas working group GTG 2007) showed that network users were satisfied with the tariffs structure and the related application procedures.

On the subject of tariffs levels, two DSOs said they would like a review of the tariff applied to them.

One of them considered that the current tariff no longer covered its costs, particularly within the context of a market opening and legal unbundling.

The same DSO added that, for the second year running, it had seen a significant drop in the growth of transported volume, due to a combination of two factors:

- a downturn in growth in terms of the number of customers,
- and, more importantly, a significant drop in unit consumption.

The other DSO considered that the common tariff level, set for LDCs which did not have unbundled accounts, was too low to cover the costs of recent networks. It suggested that the most recent distributors should be entitled to claim a slight increase in this tariff to allow for the significant investment costs borne by their network.

**The market players are satisfied with the current tariffs charged for the use of distribution networks. The suppliers draw attention to the fact that any change in tariffs charged for the use of distribution networks should be reflected in the regulated retail tariffs. Some operational difficulties with GrDF have also been raised.**

## **QUESTIONS CONCERNING THE REGULATORY FRAMEWORK**

**Question 2 :** *Do you think that the duration of the forthcoming tariffs should be two years for better understanding of the impact of market opening on 1 July 2007 and DSO legal unbundling? If you do not agree with this point of view, what in your opinion would be the most relevant duration?*

### **Suppliers and end consumers:**

Almost all the suppliers expressed their need for good visibility when preparing their commercial offers.

Four suppliers were in favour of a two-year period within the current context, but said they would prefer a longer period all the same.

Three suppliers preferred a three-year period.

For one supplier, three years would be a minimum and a four-year period would be better.

One supplier thought that a four-year period would be consistent with best practices in Europe.

Another favoured an application period of at least four years.

The last contributor was in favour of the longest period possible.

In addition, one supplier wished for transmission and distribution tariffs to be adjusted according to an identical schedule.

### **DSOs:**

Five DSOs were in favour of a two-year period. There were two reasons for this: a) to take into account the real impact of market opening and have a more accurate idea of network operating and depreciation costs and b) because two years gave suppliers the stability they needed to make their price offers, while allowing enough time for tariff levels to be adjusted to reflect changes in DSOs' expenses as accurately as possible.

Two DSOs thought that the system was well controlled and was therefore compatible with an application period of three or four years.

One DSO wished for a shift towards a four-year tariff period that would be adjusted every year according to rules defined in advance during the period.

One DSO specified that, whatever the frequency of tariff reviews, tariffs should include a correction factor to take into account changes of certain costs at least, such as earthworks, piping and labour.

Another DSO requested that the next tariff for the use of distribution networks be applied as from 1 January 2008. Should the tariff come into effect on a different date, this DSO considered that the new tariffs should include a compensation mechanism because, in its opinion, the current tariff no longer covered its costs.

### **Others:**

One contributor considered that a two-year period allowed enough time for a better understanding of the impact of market opening.

Two other contributors considered that a minimum period of three years was needed. The FNCCR pointed out that tariffs could come with annual review clauses to reflect changes in the economic situation.

**The suppliers would all like to see a longer tariff application period (3 years on average) for improved visibility of changes in tariffs for the use of distribution networks. Some are not against a two-year period within the current context. However, a slight majority of DSOs is in favour of a two-year period.**

**Question 3 :** *Do you think that a DSO productivity incentive scheme is necessary?*

**Suppliers and end consumers:**

Apart from one supplier who expressed no opinion, all the suppliers declared that a productivity incentive scheme needed to be set up. Implementation of this scheme, however, should not be detrimental to the quality of service.

One supplier stipulated that the 1.5% productivity target would seem to be the minimum percentage if applied only to certain operating costs. Another pointed out that this type of mechanism could be used to set targets and define what proportion of productivity gains would be allocated to users.

Another supplier admitted the need for a productivity incentive scheme to be set up in the medium term but did not consider it a short-term priority. DSO quality of service indicators and a continuous improvement policy were prerequisites for the implementation of a DSO productivity scheme.

One contributor considered that DSOs should be paid on the basis of a productivity incentive scheme, provided the scheme really did act as an incentive and did not affect the quality of service.

**DSOs:**

One DSO proposed setting up a regulation scheme over a four-year period, based on the following principles: commitment to quality of service, incentive with an overall productivity factor of 1.5% and an annual revaluation equal to inflation (RPI-X approach) and, lastly, implementation of the expenses and revenues clawback account (CRCP) mechanism. The DSO drew attention to the impact of full markets opening and the significant investments related to the replacement of grey-iron piping on its operating and capital costs. In this respect, the DSO confirmed its request for a tariff applicable as from 1 January 2008, for which an increase in the short term was vital if costs were to be covered.

One DSO considered it was too early to implement an incentive scheme on this tariff and that relevant analyses and well-argued diagnostics were required first. Another DSO thought that not enough time had been allowed for experience feedback to help us understand more clearly the effects of a) markets opening to household customers and b) the legal unbundling of incumbent operators.

Two DSOs approved the notion of productivity targets on controllable costs. One of them pointed out that targets should be differentiated according to company size and the efforts made. It added that its own tariff adjustment was limited and that it was therefore against any incentive scheme for the most virtuous DSOs. The other DSO said that payroll costs accounted for most of its overall costs and that it had virtually no room for manoeuvre on this point, apart from not replacing personnel leaving the company.

One DSO said that it had been making an effort for a long time and had not waited for a productivity scheme to be set up first. Another declared that productivity was a concern shared by all DSOs. Transforming LDCs into trading companies and opening up new gas concessions to competition promoted higher productivity, but network safety issues should not be overlooked. In one DSO's opinion, financial incentive mechanisms were already taken into account in the Quality Charter. Another DSO was against setting up a productivity incentive scheme, claiming that since operating costs were already calculated to the minimum, any attempt to reduce them would be detrimental to safety.

**Others:**

One contributor believed that an incentive scheme was necessary. In this way, the progress targets to be met by the operator and the share of productivity gains to be passed on to network users could be defined in transparent, contractual terms.

Another contributor considered that the principle should be made part of DSO policy, on condition that quality of service was safeguarded.

For the FNCCR, an incentive scheme could be set up for concessions within the scope of the incumbent operator without impairing DSO quality of service. It did not approve, however, of setting up such a scheme at the national level for new concessions, under the scope of tender. Instead, it was in favour of a "decentralised" incentive scheme resulting from the introduction of competition before concessions were granted, and from contractual provisions governing the conditions for reevaluating the rate of return for the concession holder.

**A great majority of market players are in favour of setting up a productivity incentive scheme. One DSO has made proposals for a multi-year scheme. Several LDCs, however, consider that efforts have already been made to improve productivity. The FNCCR is in favour of a "decentralised" rather than national incentive scheme.**

**Question 4 :** *Do you think that an incentive mechanism for monitoring quality of service is necessary? Do you have any comments on the indicators planned for GrDF (cf. appendix)? Do you have any comments on the list of indicators which could result in financial incentives for GrDF?*

#### Suppliers and end consumers:

The contributors were very largely in favour of setting up an incentive mechanism for monitoring DSO quality of service, especially if DSOs were to be expected to meet productivity targets.

Only two suppliers considered that quality of service was not a major problem and that there was consequently no need for any monitoring, apart from an indicator for supply interruptions. These two suppliers said they would prefer to identify targets and commitments rather than have indicators.

The contributors were largely in favour of introducing the indicators and incentive methods proposed. Some also suggested new indicators and four contributors wished to add to the list of indicators leading to financial incentives.

The main themes concerned by the proposed additional indicators were:

- quality of data flows transmitted by DSOs,
- quality of DSO/supplier relations (DSO organisation with respect to suppliers and quality of the OMEGA portal).

The main themes for which additional financial incentives were proposed were:

- quality of GRD/end consumer relations,
- respect of the intervention appointments (service provided on the dates requested by the customer),
- quality and relevance of information on the OMEGA portal,
- failure to meet deadlines for transmitting meter readings.

One supplier considered it important for the analysis chart to reflect percentages as well as quantities so that malfunctions concerning newcomers showed up clearly against those of the supplier Gaz de France.

#### DSOs:

Most DSOs were in favour of monitoring the quality of service.

Two considered that an incentive mechanism for monitoring the quality of service was vital, given that DSOs would eventually be expected to improve productivity. In their opinion, steps should be taken to ensure that lower identified costs were not offset by a drop in the quality of service.

One of them pointed out that the indicators should not be selected until all the players had been consulted to ensure that each player had precise information on:

- customers' (suppliers' and end consumers') real expectations,
- any extra cost incurred in achieving the desired improvement in quality,
- any saving made by tolerating a lower level of quality.

Three DSOs stated that quality of service had long been a priority for natural gas distributors. One of them said that it had already set up an in-house system for monitoring quality of service. Another DSO pointed out that quality of service was already monitored under DRIRE supervision.

Two DSOs made recommendations concerning the approach to be adopted. One of them considered that the basis for setting up any incentive mechanism to measure operator quality of service should be gradual, reliable and virtuous:

- implementation in stages, depending on the maturity of themes (from a simple report to the definition of standard targets or even financial incentives on a case-by-case basis and outside the tariff formula),
- in line with changes in IS functions,
- experience feedback required concerning market reactions to this information.

The other DSO indicated that the monitoring of certain indicators would depend on the effective deployment of suitable management tools by the DSO, in particular, certain functions of the information system. A period of time should therefore be allowed before the mechanism could be applied. Failing this, data gathering would call for very labour-intensive manual operations.

One DSO expressed reservations, saying that some indicators were not relevant for DSOs with small service areas, since all services were provided within very short times and far more rapidly than by large DSOs. It also considered that the other indicators were too heavy and quite pointless; its own competitive edge was mainly built around proximity and customer relations.

#### Others:

Three contributors were in favour of monitoring DSO quality of service.

One suggested that the indicators concerning communication between DSOs and TSOs (indicators 25 and 26 in the appendix to the consultation document) should be monitored for all DSOs, or at least for those whose business volume had an impact on the overall quality of allocations in a balancing zone.

Lastly, the FNCCR expressed the opinion that in its approach to this issue, CRE should consider the provisions of the amended version of Article 13 of law no. 2004-803 of 9 August 2004, under which DSOs were supposed to carry out their activities "*within the framework of concession technical specifications and regulations applying to the services of state-run distribution companies*". According to this law, it was clearly within this framework that DSOs should, in particular, "*guarantee access to networks under objective, transparent and non-discriminatory conditions,*" and "*operate and maintain these networks.*" Priority should therefore be given to ensuring consistency between the indicators adopted by CRE and those to be defined in the concession specifications applying to public gas distribution. This consistency could be guaranteed, in particular, through a national agreement between CRE and the FNCCR in its capacity as national representative of authorities organising public gas distribution.

**The markets players are largely in favour of setting up an incentive mechanism to monitor DSO quality of service and also accept the indicators and incentive scheme contemplated for GrDF. Additional proposals (concerning indicators and incentives) have also been made by some contributors.**

**Question 5:** *What do you think of the implementation of the expenses and revenues clawback account mechanism for natural gas distribution? Do you have any comments on the items which could be covered by this mechanism?*

Suppliers and end consumers:

Most suppliers were in favour of adopting the expenses and revenues clawback account mechanism (CRCP) for gas purchases corresponding to losses. Some of them added that this coverage should be accompanied by measures to incite DSOs to reduce their losses. Several suppliers also approved covering capital costs; only one was definitely against this idea. The coverage of weather-induced deviations was, however, more open to discussion for most suppliers and two of them were firmly against it. Two other suppliers, while not commenting on the basics of this issue, said that if this risk were to be covered, then they would prefer DSO exposure to weather-induced deviations to be reduced via the tariff structure. One of them pointed out that if the operators were to be exposed to a lower risk, then their rate of return should be lowered too.

Three suppliers considered that a CRCP mechanism should be applied to distribution in the same way as to transmission. They approved of the items covered (capital costs and the purchase of losses). Another considered that the CRCP mechanism should not be used to correct differences between the cost structure and the tariff structure. One supplier wished to avoid sudden variations in tariffs from one year to the next, as it could not integrate the extra costs in its offer if it had no visibility and no way of planning ahead. This supplier would like settlement after a sufficiently long period, like the tariff validity period. If an annual settlement were to be set up, a levelling mechanism would also be required. The same supplier added that as far as loss coverage was concerned, differences in volume should be borne by the DSOs, as they were able to take the necessary action (reducing leaks, for example). This supplier also thought that the risk of weather-induced deviations should be covered by adjusting the proportion of fixed and variable parts rather than by including it in the CRCP mechanism.

According to another supplier, only purchases of losses should be covered. Capital costs should not be covered, as users should not feel the impact of any management difficulties here, at least not until assets had been unbundled. In this supplier's opinion, weather-induced deviations should not be included in the CRCP mechanism as the entire gas supply chain was exposed to this type of risk. Whatever the case, covering this risk should lead to a much lower rate of return.

One supplier approved the logic behind the CRCP mechanism but considered it wiser to restrict its use to lesser costs, so that expanding players were not exposed to negative time lags when compensating for past costs. This supplier was also in favour of covering losses, on condition that DSOs were encouraged to improve their gas purchases and reduce the volume of losses. It considered that the risk of weather-induced deviations should be covered by the tariff structure, through adjustments in the fixed and variable part. It added, however, that this solution could only be adopted if the structure of regulated retail tariffs were adjusted accordingly. Lastly, it stated that any decrease in DSO risk should be reflected in a lower rate of return.

One supplier admitted that a CRCP mechanism was a good way of covering certain risks. The CRCP mechanism needed to be fine-tuned to enhance visibility during the tariff period for users and system operators and to avoid the build-up of regulatory assets and liabilities within a context of long-term regulation. This supplier was against including weather-induced deviations in the CRCP mechanism.

One supplier considered it preferable to set up a system which provided DSOs with the incentive to cut losses.

Another supplier found that the CRCP system was impractical and was not favourable to market opening.

DSOs:



Most DSOs were in favour of a CRCP mechanism.

One DSO thought that the CRCP provided a solution for levelling revenue from transportation activities, where most costs are fixed. However, turnover could be affected by contingencies. If it were to follow a policy of promoting gas, it would seem fair to cover the part of its revenue that was in proportion to the amounts transported. It was in favour of covering capital costs and loss purchases. Furthermore, in view of the amplitude of the requested tariff period, this DSO thought that the account should be managed on an annual basis and went on to propose a levelling system to avoid sharp tariff variations.

One DSO agreed that capital costs should be covered. It considered that one advantage of covering the volume risk was that it would take into account the DSOs' constraints (fixed costs), but rejected the idea that this should be reflected in a lower rate of return. It added, however, that to the extent that the DSO still had a role to play in developing uses for gas, there was a chance that differences in volume would not be covered by the CRCP mechanism.

Two DSOs were in favour of the mechanism for the same reasons as those that justified its implementation for transmission. They also approved of covering weather-induced deviations.

One DSO gave no precise judgement on the mechanism but considered that covering the volume risk would indeed help to reduce the DSOs' risk considerably. It accepted that this risk could be excluded from the mechanism if the rate of return on the regulated assets base (RAB) remained at a satisfactory level.

Two DSOs approved of the mechanism. One of them thought that volumes should be covered. The other pointed out that weather-induced deviations were the chief problem facing LDCs.

Another DSO said that the SPEGNN was exploring the possibility of setting up a CRCP mechanism. It did not agree, however, that the rate of return on the RAB should drop on account of the CRCP lowering the industrial risk.

One DSO thought that applying a CRCP mechanism to distribution might complicate the existing mechanism.

#### Others:

The FNCCR considered that the DSOs' request to cover the difference in revenue due to quantities demonstrated that their revenue and cost structures were not matched. It was more in favour of reviewing tariffs, with the revenue structure and cost structure moving closer together, rather than broadening the scope of the CRCP mechanism. It suggested increasing the fixed part of tariffs and setting up differentiated tariff options, on condition, however, that doing so would not undermine the users' buying power.

**The vast majority of market players are in favour of setting up a CRCP mechanism and consider that it should cover capital costs and purchases of losses. There is less agreement among contributors as to whether the CRCP should cover the risk of weather-induced deviations.**

**Lastly, according to some contributors, the operating rules of the mechanism need to be fine-tuned to limit sudden changes in tariffs.**

**Question 6 :** *What do you think of the guidelines for the tariffs of new concessions? Do you agree with the proposal to leave the pricing level to the discretion of DSOs and the authorities granting concessions? If not, what in your opinion would be the criteria to be adopted?*

#### Suppliers and end consumers:

All contributors thought that the tariff structure for DSOs serving new concessions should be in line with that of the equalised tariffs currently applied for the use of distribution networks.

As for how the tariff level should be fixed, only three market players were in favour of the proposed guidelines. Furthermore, one of them only approved on condition that a solution be found to safeguard the economic bases applicable at the time the concession was granted, without stepping outside the regulatory framework within which the administrative authorities define and approve tariffs for the use of networks. Another pointed out that it was important for all the suppliers to be informed of the tariff before marketing under the responsibility of the DSOs concerned.

Most of the other suppliers who gave an opinion on this subject were against the idea of leaving tariff levels to the discretion of DSOs. They wished for external control of tariff levels by CRE or by a government authority. In particular, three of them explained that, as far as price levels were concerned, the new concessions should be governed by the same rules for determining the tariffs charged for the use of distribution networks as those applied to existing concessions. According to them, any other method would make the DSOs' – and consequently the suppliers' – range of tariffs more complex, which would be detrimental to competition (in particular because of a lack of clarity for the end consumer).

One supplier pointed out that the number of new municipalities was small compared with the number of existing concessions and that extra costs due to information systems and the complexities of managing different tariff rules would increase without benefit to the consumer.

Another explained that the Gaz de France regulated retail tariff only had six levels and was not supposed to vary with distribution costs. It went on to say that too great a difference between distribution tariff levels would have much the same effect as creating cross-subsidies between customers.

#### DSOs:

All the DSOs believed that the structure should be the same for all DSOs and all concessions.

Opinions diverged, however, on the extent to which the level of these tariffs should be controlled:

- Six DSOs were in favour of the tariff level – and its adjustments over time – being agreed upon jointly by the concession granting authority and the concession holder, even if, in the end, the level were proposed by CRE and determined by the Minister. Nevertheless, one of them proposed setting up limiting criteria defined by law.
- The others were against this idea, mainly because of costs relating to the information system and the increasing complexity of the system.

#### Others:

Two contributors were in favour of the proposal.

**There is a consensus that the equalised tariff structure currently in force should be applied to new concessions. However, the market players – particularly suppliers – do not share the changes introduced by the law of 7 December 2006. In view of this situation, most of them are against the idea of leaving the tariff level to the discretion of the DSOs.**

## **QUESTIONS CONCERNING THE LEVEL OF AUTHORISED REVENUE**

**Question 7 :** *What do you think of the principles currently in force for defining the level of*

*authorised revenue for operators (RAB valuation method, etc.)?*

Suppliers and end consumers:

Five suppliers had no observation regarding the current method used to determine the level of revenue.

One supplier observed that two methods were used for calculating capital costs. CRE applied one of these methods for electricity grids and the other for gas networks. For the same rate, the second method offered gas network operators higher profitability, the difference being roughly equal to the inflation rate.

One supplier said that a unit cost scale would be practical.

Another supplier questioned the use of a GDP trade index for revaluing the historic values of DSO assets as at 31/12/2002, given that after 2002, the consumer price index had been used for this purpose. It went on to say that the consumer price index measured trends in the prices of goods consumed by households; it was irrelevant and should be replaced by industrial price indices.

Lastly, one supplier considered that a benchmark with European operators should be available to compare RAB scopes.

DSOs:

Most DSOs considered that the principles adopted for calculating authorised revenue were appropriate, although one of them pointed out that it was too soon for it to make a clear judgement in comparison with the current rate.

One DSO agreed on the methods used to determine the RAB and the different components of authorised revenue for monopoly concessions. It said that rules for new concessions should be determined within the context of a market open to competition.

Another DSO considered that DSOs should have a regulatory framework and long-term methodology for defining their investment policy.

One DSO said that a 50-year lifetime for networks and connections was too long. Based on the precautionary principle, lifetime should be reduced to 40 years here.

Another DSO pointed out that, although it did not agree with some provisions (e.g. the lower rate of return under ATRD 2), the calculation methodology did work. One DSO was in favour of the current cost-plus system and would have liked to see it extended, before developing into another type of system, such as a price-cap system. Another DSO considered that the principles applied were appropriate in that they covered the costs inherent in maintaining quality and safety, both issues of public concern now that markets were to be open to competition.

Others:

The FNCCR considered that assets could only be valued on the basis of perfectly reliable inventories, the problem being that no detailed inventory was available for connections (40% of the assets granted).

**Most DSOs agree with the principles adopted for calculating authorised revenue. Most suppliers either have no comment or else find the current method used to determine the level of revenue appropriate.**

**Question 8 :** *What do you think of the rate of return in force for natural gas distribution activities?*

### Suppliers and end consumers:

Two suppliers had no comment on the rate. Another found the rate acceptable as it was representative of those currently applied.

One supplier was in favour of a cost-plus system but made no comment on the current rate of return of 7.25%.

Another supplier observed that different methods were used for electricity (nominal rate) and gas (real rate).

Two suppliers thought the rate too high for an activity where temperature was the only risk.

One supplier explained that this rate had been reviewed at the end of 2005 to allow for new developments that had taken place on capital markets since the former rate of return had been determined, and that the new rate should be determined on the same basis.

Another supplier had no comment on the rate. It pointed out, however, that, whatever the rate, suppliers should be able to pass distribution costs on to the end customer. Furthermore, it considered the tariff levels proposed by the DSOs disproportionate and said that the 11.7% increase requested by GrDF would increase the "tariff pinch" for newcomers. It added that there was no justification for the increase proposed by the DSOs: newcomers should not be expected to pay the 1.7% increase related to changes in volume, for it was the operators who accepted this risk when they invested in networks. In addition, the 6.3% rise in operating costs should be offset by efforts to improve productivity.

### DSOs:

One DSO explained that the rate of return should reflect and take into account the following:

- an objective view of market items used to determine the distributor's weighted average cost of capital (WACC),
- an examination of parameters specific to the distributor (spread, lever) and the risk to which the gas distribution activity in France is exposed (beta coefficient),
- the specific nature of the method used to calculate the rate-of-return component in capital costs: this component is restricted to assets not fully depreciated and is based on the RAB, which is a partially depreciated value,
- the fact that capital costs do not cover assets withdrawn before their theoretical end-of-life,
- the fact that operating costs do not cover future dismantling costs,
- making the distributor responsible for improving productivity,
- and, more generally, the overall balance that helps to obtain the signed authorised revenue.

One DSO thought it necessary to wait for the result of the comparative study of rates.

Two DSOs approved of the applied rate. According to them, the rate of return on DSO assets should be aligned with those used for transmission to improve transparency and ensure that network operators were treated on a more equal footing. For one of these DSOs, a preferential rate could be applied to calculate the return on investments made to improve personal safety.

One DSO said it was against lowering the rate under ATRD 2.

**Many suppliers have no comment on the current rate of return. A few of them, however, say it is too high. Most DSOs are satisfied with the current rate of return. One of them considers the rate should reflect several factors (scope of the RAB, overall balance of authorised revenues, etc.).**

**Question 9:** *What do you think of CRE's decision for management of concession fees paid to concession granting authorities within the framework of the ATRD 2 tariffs in force?*

### Suppliers and end consumers:

Five suppliers were in favour of excluding concession fees.

One supplier thought that these fees should be included, since they were contractual obligations from which the concession holder could not break free without specific legal provisions.

One supplier had no opinion on the matter.

#### DSOs:

The eight DSOs that replied to this question were against excluding concession fees from the costs to be covered. They considered these fees as contractual clauses and asked CRE to reconsider its position on the subject.

#### Others:

Two contributors considered that the concession fees were paid in exchange for a service including costs arising from missions and public service contracts.

<b>The suppliers are in favour of excluding concession fees. The DSOs, however, consider these fees as costs to be covered and ask CRE to reconsider its position.</b>
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**Question 10 :** *What do you think of the DSO request for incorporation of costs related to the development of gas usages? Do you think that DSOs should contribute to the development of gas usages?*

#### Suppliers and end consumers:

Only one supplier was against promoting the use of gas to existing customers, claiming that it was part of supplier-customer relations. In this supplier's opinion, only costs promoting new gas connections could be taken into account.

The other nine suppliers were in favour of DSOs promoting the use of gas, provided that these activities were of benefit to suppliers and not only to DSOs and, more importantly, of benefit to each and every supplier. One of them underlined that it was only in favour if these gas promotion activities were not carried out under the name of an incumbent supplier.

#### DSOs:

All the DSOs thought it necessary to consider how costs related to the development of the use of gas could be taken into account in the calculation of network tariffs. This was necessary because new suppliers were only interested in existing customers, and incumbent suppliers were mostly concerned with securing customer loyalty. As a result, the DSOs were the only ones who had to invest in finding new customers at a time when development was difficult (due to competition from electricity and alternative energy sources). Moreover, if the DSO had no incentive to promote gas to offset these losses, the drop in volumes would automatically lead to an increase in the tariffs charged for the use of distribution networks. One of them explained that the cost of promoting the use of gas was relatively low in comparison with overall operating costs and that the investment would really pay off for the company, which would ultimately be able to profit from all network users via tariff revisions.

#### Others:

Two contributors considered that the DSOs should help to promote the use of gas. One of them said that if nothing were done to alter the current trend, network tariffs would eventually go up much more to offset the loss of distribution revenue induced by slower consumption. The choice had to be made

between an immediate – but slight – increase in expenditure and a forced and much more significant increase in distribution tariffs in the future.

The FNCCR had doubts. It believed that the promotion of natural gas by DSOs should be part of the government's energy policy. Promoting natural gas should be aimed at reducing greenhouse gas emissions and not lead to the replacement of more effective sources of energy. It should also take into account objectives concerning the control of energy demand.

One last contributor rejected the DSOs' request, saying that there was no reason why customers already connected or new subscribers should have to pay for communication operations. The cost of this type of operation should be financed out of DSO profits.

**All the contributors except three (including one of the ten suppliers expressing an opinion) are in favour of incorporating costs related to the development of natural gas in the tariffs charged for the use of networks.**

**Question 11 :** *What do you think of the DSO request for incorporating costs related to safety of indoor installations? Do you think that DSOs should fulfil this remit?*

#### Suppliers and end consumers:

Three suppliers were opposed to the request made by GrDF. The first thought that this issue should be examined at a later date, since, in the immediate future, the DSOs of incumbent companies are unlikely to undertake this activity, at least not until effective unbundling, a complete change of name, or even the unbundling assets occurs, given that there is too great a risk of discriminatory practice. The second thought that, while it is only natural that DSOs should be involved in ensuring the safety of indoor installations, this is an activity that is independent of gas transmission and metering and that, as such, there is no reason why the cost of this activity should be included in the tariff. This supplier suggested including these costs in the catalogue of services. The last thought that the gas working group studies GTG 2007 had already defined the activities and responsibilities of each type of player: customers, professionals, regulating authorities and DSOs. The DSO's remit insofar as concerns the safety of indoor installations is, he believed, to check that certificates are provided, the cost of which is already included in the tariff.

Six suppliers stated that they were in favour of DSOs carrying out certain activities related to the safety of indoor installations. In their opinion, safety is not just another argument to make the service more competitive; it helps create a better image of natural gas in the eyes of the consumer and thus boosts development. They thought that DSOs are in a good position to carry out these activities, given their proximity in the field.

One of the suppliers also pointed out that if these activities were performed by DSOs, this would ensure harmonisation across the country, independently of the suppliers, and this in the long-term thanks to regulated incomes.

Another said that the suppliers should have the right to examine the budget allocated for this activity and to check performance, to ensure that it is undertaken in accordance with the principles of non-discrimination and transparency to which DSOs are subject.

#### DSOs:

All the DSOs except one were in favour of the costs related to the safety of indoor installations being incorporated in the tariffs for the use of distribution networks, in the interests of the gas industry (gas explosions, whether they occur in the public or the private area, create a negative image of natural gas). They said that DSOs have the expertise required and that they are in the best position to handle the logistics and financing required for this activity. Moreover, three DSOs thought that suppliers are not sufficiently involved in information campaigns dealing with the issues related to using gas aimed at the end customer (carbon monoxide poisoning, etc.).

The one DSO that opposed the proposal thought that it was not the DSOs' job to ensure the safety of indoor installations and that the same system as that applied in the electricity sector should be set up, namely, that safety is managed by a third party, which performs safety audits and ensures that installations are compliant.

Others:

The FNCCR was in favour of DSOs managing this activity.

**The majority of suppliers are in favour of some of the costs related to the safety of indoor installations being incorporated in the tariffs. The DSOs are almost unanimously in favour.**

**Question 12 :** *What do you think of the transfer to TSOs of costs for alignment and adaptation of delivery stations at the interfaces between transmission networks and distribution networks?*

Suppliers and end consumers:

Three suppliers were in favour of transferring these costs to the TSOs, implying the apportionment of costs to the organisation which is in charge of these stations, provided that such a transfer will not effect costs for the suppliers.

Four suppliers were against transferring these costs to the TSOs. One said that only DSOs should control these costs. Two suppliers questioned whether such a transfer, which, in their opinion, would be detrimental for customers whose demand is highly modulated, was appropriate at this time. The last thought that these costs were not the TSOs' responsibility and carried the risk of not producing savings for the DSOs.

One of the suppliers asked that connection contracts signed by TSOs with their customers should be aligned with those signed by DSOs for transmission / distribution network interface points, to ensure that delivery terms reflect the same costs.

DSOs:

Of the five DSOs that expressed an opinion on this subject, four were in favour of transferring these costs to the TSOs. The main reasons given were:

- since delivery stations are an integral part of TSO networks, and are operated and regularly maintained by them, the TSOs have total control over the work schedule related to the required maintenance actions;
- allocating an annual budget to the TSOs for this item as part of their tariff income, would enable them to plan multi-year investment programmes more efficiently;
- transferring these costs to the delivery capacity charge for transmission distribution interface points would make it possible to pass on the cost of transmission as closely as possible to the actual cost, whilst eliminating price differences for distribution, which are solely related to the period when a delivery station was set up.

One DSO was against transferring these costs to TSOs, in view of the fact that it owns the engineering structures for connecting to the transmission network, as shown in its RAB. Similarly, operating costs are eventually entered in its accounts as operating expenses. This DSO said that, in its case, a general policy in favour of GrDF's request would lead to these costs being accounted for twice for its transmission / distribution network interface point.

Others:

One contributor thought that delivery stations, together with pressure reduction stations, should be transferred to TSOs, thereby improving the "return on investment" in some cases. More generally, it thought that, if DSOs want a better regional gas service, then transmission infrastructures need to be

reviewed and extended, in order to avoid, within the framework of public service delegation contracts, having to deal with infrastructures which, depending on linear configuration and diameter resemble transmission networks.

One TSO thought that going ahead with such a transfer was conditional upon the publication of a CRE deliberation to guarantee that the changes planned create economic balance and are financially neutral for every player in the market.

The other TSO was against transferring costs relative to delivery stations from DSOs to TSOs, since it could not see how this would improve on the existing system, which, it added, has the following advantages:

- Designated costs, in avoiding the risks involved in pooling between transmission / distribution network interface points that have high connection charges and those with lower connection charges. In this case, LDCs with low operating levels are liable to suffer if the proposed change is introduced;
- bipartite cost control, which is a factor in ensuring efficiency.

It would prefer to see improvements made to the existing system.

**Suppliers and TSOs are divided on this proposal. One of the TSOs was not against the idea, provided that CRE could ensure economic balance and financial neutrality. The DSOs are mainly in favour of the idea.**

**Question 13:** *What do you think of the changes in the management of losses and differences planned for GrDF?*

Suppliers and end consumers:

Seven suppliers were in favour of procuring gas to cover losses by posting calls for tender from potential suppliers, provided, according to three of them, that this would be implemented in a transparent and non-discriminatory manner.

One supplier questioned the feasibility of the proposal and the conditions required for implementation. In its opinion, the recent use of OMEGA for calculating distribution imbalance accounts still needs enough time to stand back and check whether these accounts consistently converge in line with the various losses and differences, and to profile losses. The same supplier also wanted the mechanism to act as an incentive to reduce losses.

Another suggested partially including this item in the expenses and revenues clawback account (CRCP).

DSOs:

Two DSOs thought that this change would probably be beneficial for GrDF but could not see themselves implementing such a change. GrDF is also in favour of the proposal.

One DSO thought that, until the gas market reaches an adequate level of maturity, it is not feasible for LDCs to procure supplies on the markets.

One DSO said that this situation could not be applied in the case of LDCs which are under no obligation to unbundle their activities. Allocating the cost of losses is managed within the framework of account unbundling based on total gas purchased by the LDC.

Others:

One contributor was in favour of the proposal but wondered how it would be implemented. In fact, in its opinion, gas should be traded at Gas Exchange Points on the transmission networks (a market



limited to shippers already present on a DSO network would be too small to allow any real competition), implying, at first analysis, that DSOs should become shippers on the transmission network.

FNCCR had some reservations. It was in favour of the proposal insofar as concerns losses and differences that do not come under the DSO's responsibility, namely technical losses. On the other hand, it was against it in the case of the other elements that come under this item, in a bid to encourage DSOs to reduce such losses and differences.

**The majority of market players are in favour of GrDF procuring gas to cover losses by means of a call for tender process that would be transparent and non-discriminatory.**

### **QUESTIONS CONCERNING THE TARIFF STRUCTURE:**

**Question 14 :** *What do you think of the general principles of the tariff structure?*

Suppliers and end consumers:

All the suppliers said they were satisfied with the current structure. They all wanted it to be maintained. One of them did point out, however, that if the DSOs think that the existing structure fails to reflect their cost structures adequately, it would be a good idea to change it.

DSOs:

All the DSOs said that they were satisfied with the tariff structure and wanted to keep the current principles on which it is based.

One of them nonetheless wished to minimise the risks to DSO revenue related to variability in the quantities distributed, but suggested doing so via the Expenses and Revenues Clawback Account.

**All the market players are satisfied with the general principles on which the tariff structure is based.**

**Question 15 :** *Do you think that the system in force for pricing of second tier distribution networks is applicable as it is for the new concessions concerned by tariff differentiation?*

Suppliers and end consumers:

All the players in the market who responded to this question were in favour of the application as it is of the system in force for pricing of second tier distribution networks, for the new concessions concerned by tariff differentiation.

DSOs:

The DSOs that gave a response to this question were all in favour.

Others:

The FNCCR thought that second tier DSOs should benefit from special tariffs related to the fact that they are not end customers. Some services covered by the tariff are simplified or optional services in the case where the user is a DSO. The tariff applicable to second tier DSOs should primarily cover costs incurred by first tier DSOs acting as intermediaries for second tier DSOs to access the transmission network.

**The majority of market players are in favour of applying the current pricing system for second tier distribution networks, for the new concessions.**

**Question 16:** *What do you think of the GrDF request concerning rebalancing between the fixed parts and proportional charges in the tariff segments?*

Suppliers and end consumers:

Six contributors were in favour of such rebalancing, insofar as it would reflect DSO costs more accurately. One of them, however, would prefer that the neutrality threshold was changed to 30 MWh/year, in a bid to minimise the impact for smaller customers and comply with tariff structures for regulated retail tariffs. Another supplier said it did not want to see any further increases to the fixed part of the tariffs.

One supplier said that the possible implementation of rebalancing should comply with the following principles:

- compensation for only a part of weather-induced deviations under this mechanism;
- gradual introduction, so that regulated retail tariffs can be adjusted at an acceptable pace for the customer and all the stakeholders.

Two suppliers thought that rebalancing would send out a negative signal regarding energy demand management in the current context. One of them, on the contrary, in support of the idea of reducing energy consumption via by means of the tariff, suggested, firstly, differentiating more clearly between the fixed and variable parts of the tariff and, secondly, consolidating the variable part.

One supplier noted that the threshold of 25MWh is close to average consumption for a house and would push up the cost of gas in new constructions.

DSOs:

DSOs were in favour of the rebalancing proposed, insofar as it would make them less dependent on weather-induced deviations.

However, one of them noted that, to maintain tariffs continuity at current thresholds, this would require raising tariffs for one tariff segment and lowering them for others. As a result, this would lead to cross-subsidies between different tariff segments, which it did not agree with.

For another DSO, this rebalancing is essential since T1 tariffs do not cover its costs as it is.

One DSO pointed out that it should be possible to pass on variations in the fixed terms of the Third-Party Access to Distribution Networks (ATRD) tariff to the fixed terms of regulated retail tariffs, rather than to the variable terms (kWh) of these tariffs alone.

Others:

The FNCCR was in favour of the proposed rebalancing.

**The majority of DSOs are in favour of rebalancing. A narrow majority of suppliers is also in favour of rebalancing.**

**Question 17 :** *Are you in favour of the scope of services included in the LDC tariffs being aligned with that of GrDF?*

All the suppliers and end consumers who responded to this question said that they were in favour of harmonising the scope of services. One of them suggested a period of adjustment if necessary.

Two DSOs were against harmonisation, believing that each DSO has its own specificities.

The other DSOs who answered this question were in favour, possibly requiring a period of adjustment since this impacts on the company's accounting system and information system.

**Except for two DSOs, all respondents that answered this question are in favour of harmonising the services included in the tariffs.**

### **OTHER QUESTIONS:**

**Question 18 :** *Do you have any comments concerning distribution system operators' catalogues of services?*

#### **Suppliers and end consumers:**

Three suppliers wanted services to be aligned in terms of their nature and their price.

One supplier wanted a compensation procedure set up for customers and suppliers in the event that the DSO breaches of its obligations (delivery on schedule, punctuality, etc.).

Two suppliers brought up a problem regarding the lack of consistency between the services classification system used in the catalogue, and that used in other contractual documents (distribution / transmission contracts, including agreements on representation and standard delivery terms and conditions).

One supplier suggested that the services catalogues should be subject to supplier approval, given the fact that the supplier has to provide the catalogue and offer DSO services to customers. It also suggested that DSOs could provide training for some supplier employees.

One market player raised the following points related to the prices of certain services:

- Problem of consistency between prices for services, seen when exercising eligibility, between regulated retail tariffs and prices in various DSO services catalogues;
- Lack of transparency regarding costs when issuing quotations (no details that can be used to relate the cost of services as shown in the catalogue);
- No optimisation of the cost of meter rental; in the event of a drop in consumption;
- The initial rental fee is too high: 15.6% of the value as new of rented equipment, even though the economic life of such equipment is 20 years;
- Unjustifiable changes to connection deadlines for customers whose meters are not read every six months when a technician is required to visit the premises.

#### **DSOs:**

DSOs made no comment on the services catalogues, except for one, which specified that it wanted to maintain the system whereby different DSOs have different costs.

**The majority of market players are satisfied with the services catalogues. Some nonetheless pointed out certain inconsistencies and other points with which they were dissatisfied with regard to certain services.**

**Question 19 :** *Do you have any other remarks concerning current tariffs and terms for the use of natural gas distribution networks?*

Suppliers and end consumers:

The contributors mainly made comments on the following subjects:

- *Alignment with regulated retail tariffs:*

Three suppliers mentioned the need for alignment with regulated retail tariffs for gas and the need to pass on any possible increase in tariffs. One of them noted that the demand made by the majority of DSOs to substantially increase the distribution tariff would have a major impact on the total price of gas since the percentage of the tariff for distribution is almost 50% of the total price of gas for residential customers: a rise of 11% for T1 customers implies a rise of nearly €3/MWh, in other words, a 6% increase on total supply. Another supplier stressed that such an increase in the distribution tariff, if it did not occur hand in hand with an increase in regulated retail tariffs, would make it impossible to develop market offers able to compete against the regulated retail tariffs, and would therefore block the opening of the market in the long term.

- *Exceeding subscribed capacity:*

Two suppliers wanted a change to the rules regarding exceeding subscribed capacity, with a view to applying the same principles as those in force for the tariffs for using transmission networks. One of them suggested that the excess threshold should be raised to do away with penalties for exceeding delivery capacity at transmission/distribution network interface points on the transmission networks. According to this supplier, this would make it possible to introduce allocation of capacity levels directly for balancing zones rather than at transmission/distribution network interface points.

- *Interruptible capacity:*

Two suppliers wanted interruptible capacity to become available on the market. One of these thought that the lack of an “interruptible” option in the current tariff structure makes the eligible offer less competitive than some regulated retail tariffs which include this option. This supplier wanted the price of interruptible capacity to be lower than that of firm capacity. The other supplier thought that this would facilitate operational processes for reserving interruptible capacity on the transmission network upstream of transmission/distribution network interface points, by directly linking interruptibility to the sites concerned in the distribution networks. This supplier thought that the price of interruptible capacity should be the same as firm capacity (since there is no congestion on the distribution network).

- *Proximity tariff:*

One supplier said that the fact that the public do not know the distance between their premises and the transmission network makes the systematic use of this tariff difficult.

DSOs:

One DSO wanted the transportation tariffs to take the problems of new distributor into account, to help them develop their networks.

One DSO wanted the common tariff level to take account of new costs arising as a result of opening up the energy markets.

Others:

One contributor wanted CRE to include, in the network tariffs, provisions for measures enabling biogas to be injected from production sites into the distribution networks. This contributor also thought that other developments should be taken into account so that it would eventually be possible to transmit biogas injected in distribution networks to Gas Exchange Points.

**The key point raised by this question is the need to ensure alignment between tariffs for using the distribution networks and the regulated retail prices of natural gas. In particular, any changes in the tariffs for using the networks should be passed on in the regulated retail tariffs to avoid blocking competition between suppliers. Other requests or points to keep an eye on insofar as regards the tariffs for use of the networks were also raised.**

## List of respondents

### Consumers:

- Dalkia

### Current or potential suppliers:

- Altergaz
- EDF
- Eni
- Gas Natural
- Gaz de Bordeaux supplier
- Gaz de France Direction Commerciale (Sales&Marketing Directorate)
- Gaz de Bordeaux supplier
- Poweo
- Soteg
- Tegaz

### Distributors:

- Energies Services Lavaur
- Gaz de Barr
- Régaz
- GrDF
- Gaz de Strasbourg
- Gedia SEML – Dreux
- Soregies
- Veolia Eau – Gaz de Huningue
- Vialis (public distribution company for Colmar)

### Others:

- AFG
- Club Biogaz
- FNCCR
- GRTgaz
- TIGF
- SIEML (Syndicat Intercommunal d'Energies de Maine-et-Loire – intercommunal energy syndicate for Maine-et-Loire)