

Public consultation concerning pricing principles for utilisation
of natural gas distribution systems in France

Technical consultation document

Foreword

The law of 3 January 2003 guarantees all consumers and suppliers open non-discriminatory access to public distribution systems of natural gas and rules that decisions on tariffs for utilisation of these systems are made by the Ministers for the Economy and Industry upon proposal from CRE.

On 18 December 2003, CRE proposed initial tariffs for utilisation of public distribution systems of natural gas, which concern Gaz de France and 22 local distribution companies (ELD), to be applied as from 1 July 2004 for between 12 and 18 months.

These tariffs were effectively applied by distribution system operators as from 1 July 2004 and were officially enforced on 1 January 2005 with the Decree of 14 January 2005.

CRE is planning on making a proposal to the Ministers for the Economy and Energy of new tariffs for utilisation of natural gas distribution system in October 2005, to be applied as from 1 January 2006.

These new tariffs take into account the effects of pension scheme reform concerning electricity and gas industry employees mainly resulting in the setting up of a contribution levied on natural gas distribution services. Prices incorporate results of audits of the operators' unbundled accounts and productivity gains.

1. Allowed revenue

In compliance with CRE deliberation of 18 December 2003, the main rules governing definition of operators' level of allowed revenue which have been adopted for setting initial tariffs for utilisation of public distribution systems are as follows.

1.1. Capital costs

Capital costs consist of both depreciation allowance and return on invested capital. Calculation of these two components depends on valuation of each operator's regulated asset base (RAB).

- **Calculation of regulated asset base**

Initial RAB value was set as at 31 December 2002 based on revaluation of original values of the operator's assets. The revaluation method is based on the application to these original gross values of:

- An inflation index so as to cover any changes in the general price level. The inflation index adopted for this calculation is the index "PIB marchand";
- Industrial depreciation so as to consider technical and economic obsolescence of these assets. This depreciation is calculated according to the straight-line method during normative asset lifetime (50 years for pipelines and connections, 40 years for gas pressure regulator stations and between 5 and 30 years for other asset categories).

Once fixed as at 31 December 2002, this initial RAB value changes from year to year depending on:

- Consumer price index excluding tobacco year-over-year from July to July, as published by the *Institut National de la Statistique et des Etudes Economiques* (INSEE);
- Depreciation calculated according to the straight-line method during the normative asset life as indicated in the following paragraph;
- Removal of assets from the operator's ownership (sales and disposal);
- New investments made by the operator.

As at 1 January 2004, the RAB value of distribution system operators (DSOs) with unbundled accounts was:

- Gaz de France: 11,742 million Euros;
- Gaz de Bordeaux: 269 million Euros;
- Gaz de Strasbourg: 187 million Euros;
- Régie Municipale de Colmar (VIALIS): 38 million Euros;
- Gaz Electricité de Grenoble: 34 million Euros;
- Régie Municipale de Dreux (GEDia): 33 million Euros;
- Gaz de Barr: 23 million Euros;
- Syndicat Intercommunal de Huningue, St Louis, Hégenheim et Village Neuf: 19 million Euros;

- Service Gaz et Eau de la Ville de Guebwiller: 16 million Euros;
- Régie d'Équipement et de Gaz de la Vienne: 12 million Euros.

- **Calculation of capital expenses**

The annual depreciation allowance is calculated according to the straight-line method based on residual asset value as at 1 January every year. Normative asset life used for this calculation is that indicated for revaluation of original assets as at 31 December 2002, except for pipelines and connections, for which an asset life of 45 years has been adopted.

The amount of financial return is calculated by applying to the RAB as at 1 January every year a rate of return, which must reflect the operator's capital costs.

The rate adopted for setting initial tariffs for utilisation of distribution systems is 7.75% real rate before tax.

1.2. Operating costs

Operating costs covered by tariffs for utilisation of natural gas distribution systems could be evaluated in the same way as for initial tariffs by taking into account changes since then, including:

- Pension scheme reform of electricity and gas industries as from 1 January 2005. This resulted in suppression of balancing contributions paid by DSOs and of recognition of external fund expenses, which were replaced by discharge payments made to the national pension scheme for electricity and gas industries and coverage of specific future rights;
- Audit of unbundled accounts of Gaz de France and local distribution companies by CRE, resulting in a certain number of corrections to allocation of expenses.

Moreover, taking into account opening up of the market to competition, customer management costs for public distribution (physical and telephonic reception, especially related to connection and to gas safety, information, invoicing, debt recovery and litigation), which in current tariffs are evenly split between supply activities and distribution system operations, could be allocated differently so as to incorporate the more significant role of supplier within the management of customer relations.

Finally, as part of the presentation of reasons for its initial tariff proposal for utilisation of natural gas distribution systems, CRE indicated that fees paid by operators to the franchising authorities concerned, for which no recompense had yet been established, or only partially, were nevertheless included in the costs to be priced, pending a detailed review when setting the next tariffs.

According to the hypothesis where payment of fees or part of these fees to the franchising authorities concerned would have the sole effect in exchange of the operator being designated as exclusive operator of natural gas distribution in the franchised area, it is no longer envisaged to retain these fees in the costs to be charged.

2. Calculation method and application duration of next tariffs for utilisation of distribution systems

Gaz de France Distribution System Division has proposed that pricing principles and rules for changes to the average level of unit tariffs should be set for at least three years by incorporating a productivity target according to an RPI – X type formula.

Such a method of regulation requires reliable forecasts so that realistic targets of productivity gains are set for operators.

The deadline of 1 July 2007 is likely to have significant impact on the management mode of natural gas distribution in France, mainly due to subsidiarisation of DSOs. Taking into account these uncertainties, it is planned to set the pricing framework for a period not exceeding this deadline.

Within this context, tariffs for utilisation of distribution systems belonging to the 23 French DSOs are to be based on hypotheses of costs and quantities for the year 2006.

Operators' productivity gains in 2004 and 2005 and expected for 2006 are also incorporated.

Operators' productivity drives must not be made at the expense of quality of service and therefore quality of service is to be closely monitored.

3. Pricing structure for utilisation of distribution systems

3.1. Reminders concerning current pricing structure

Tariffs for utilisation of natural gas distribution systems involve more than 11 million end customers. In order to facilitate actual deregulation of the French gas market, these tariffs must be as simple and as transparent as possible. CRE therefore adopted the following general principles for its pricing proposal of 18 December 2003:

- Setting of a tariff specific to each DSO which has unbundled accounts and a tariff common to all other DSOs;
- Geographical equalisation for each DSO;
- Pricing structure common to all DSOs, composed of four main tariff options, corresponding to the following customer categories:

T1 binomial option:	Annual consumption from 0 to 6,000 kWh;
T2 binomial option:	Annual consumption from 6,000 to 300,000 kWh;
T3 binomial option:	Annual consumption from 300,000 to 5,000,000 kWh;
T4 trinomial option:	Annual consumption above 5,000,000 kWh.

For a given delivery point, the choice of optimum pricing option is left up to the shipper. The tariff applied to a shipper is equal to the sum of what is due for each delivery point supplied.

- Definition of each pricing option so that revenue obtained corresponds to costs allocated to the customer category concerned, so as to avoid any cross-subsidies between the different customer segments.

Tariffs also include a special pricing option called "proximity tariff" so as to enable high consumption customers located near gas transmission systems, already supplied by distribution systems, to benefit from a system access tariff more comparable to that they would have paid with direct connection to the transmission system.

Judging from initial experience feedback on current tariffs, in force since 1 July 2004, it seems that the general principles described above can be maintained. However, certain modifications are envisaged:

3.2. Case of second tier distribution systems

According to current tariffs in force, a special pricing option called “second tier distribution system” is defined to cover the specific case of the DSO Gaz de Barr, connected to the distribution system belonging to Gaz de Strasbourg.

Other similar situations are likely to arise, especially within the framework of tenders for natural gas supply to new franchises, if they cannot be connected to the natural gas transport system under satisfactory economic terms.

It is therefore necessary to draw up a rule covering existing and future cases in a generic manner.

3.3. Penalties for exceeding capacities

Current tariffs in force include a penalty mechanism for exceeding capacities subscribed in the pricing options T4, “proximity tariff” and “second tier distribution systems”.

Such a penalty system is indispensable for pricing options including peak capacity subscription so as to encourage system users to reserve proper capacities in line with their peak needs and must be strictly neutral for DSOs in financial terms.

However, judging from experience feedback on the winter of 2004-2005, it appears that the current level of penalties might be too high. Especially end customers concerned (around 3,500 sites consuming more than 5 GWh per year) are not used to managing their peak consumption in a rigorous way since the penalty scheme for regulated sale tariffs is much more flexible.

If any modification is made to the current penalty scheme, it will be a reduction.

3.4. Other items

a) Scope of services included in tariffs for utilisation of distribution systems

Due to differences in the franchise specifications applicable to the various DSOs, tariffs for utilisation of distribution systems currently in force contain minor discrepancies in terms of scope of services.

Especially, certain services charged for within the framework of the DSO Gaz de France’s catalogue of services can be included in the tariff scope for utilisation of distribution systems for other DSOs.

It is planned to standardise the scope of services included in the next tariffs in line with that of the DSO, Gaz de France, which transports 96% of natural gas distributed in France.

b) Offer of daily capacity subscriptions

Tariffs for utilisation of transmission systems currently in force offer the possibility of subscribing a one day capacity on regional systems to fulfil end users’ occasional or sporadic needs.

In order to fulfil the same need with distribution systems, the same type of daily subscriptions might be proposed for distribution systems at the same price as for transmission, at a twentieth of the corresponding monthly subscription and at a thirtieth if capacity can be interrupted.

CRE invites those who wish to transmit any observations and comments concerning the general principles proposed in this consultation document to do so by **16 September 2005 at the latest**. For information purposes only, some questions are listed below:

Question 1 : *Do you have any experience feedback on current tariffs and terms for natural gas distribution systems?*

Question 2 : *What do you think of the principles adopted by CRE to determine operators' allowed revenue level (RAB valuation method, rate of return on invested capital, etc.)?*

Question 3 : *Do you think that the share of customer management costs for public distribution, currently borne to the tune of 50% by tariffs for access to distribution systems should be quite significantly reduced, for example to 20%, so as to take into account the increasing role of suppliers in management of customer relations?*

Question 4 : *Do you think that fees paid by certain local distribution companies to franchising authorities, with no recompense other than authorisation granted to these operators to be the sole operator within the franchised area should be included amongst costs covered by tariffs for utilisation of natural gas distribution systems?*

Question 5 : *Would you like the next pricing validity to expire on 1 July 2007 or extend beyond then?*

Question 6 : *Do you think that a mechanism for monitoring quality of service is necessary? What elements of quality of service would you like to see monitored? And how?*

Question 7 : *What do you think of the general principles governing pricing structure (cf. § 3.1 of this technical consultation document)?*

Question 8 : *Do you think that specific pricing terms should be provided for second tier distribution systems?*

Question 9 : *Do you think that the level of penalties for exceeding capacities should be reduced?*

Question 10 : *Are you in favour of the scope of services included in tariffs being brought into line with that of the DSO Gaz de France?*

Question 11 : *Do you think it necessary to propose daily capacity subscriptions? What do you think of prices proposed?*

Question 12 : *Do you have any comments concerning DSOs' catalogues of services?*

Question 13 : *Do you have any other remarks concerning tariffs and methods for utilisation of natural gas distribution systems?*