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Dear Andy

Ofgem's Proposed Corporate Strategy and Plan 2005 – 2010

I refer to the above document published by Ofgem in January where it sets out its plans for the coming year in the context of a 5 year strategy. Shell Gas Direct (SGD) supplies gas to non-domestic consumers as well as being a gas shipper. We have a number of comments to make on the proposed plan which we outline below. In summary:

- We support Ofgem's goal of improved efficiency. This should be reflected in better prioritisation and coordination of interacting projects.
- The introduction of impact assessments is welcome but more analysis is required to ensure that the costs of regulation are understood based on robust cost-benefit analysis.
- Workgroup discussions cannot, and should not, replace proper consultation practice.
- Ofgem has made statements supporting best regulatory practice; it now needs to demonstrate this approach as routine.

Better regulation and improving Ofgem's efficiency

Many industry participants have raised with it the scope and pace of change it imposes on the gas and electricity industries. While this is acknowledged by Ofgem, we remain concerned that it is still trying to carry out too many diverse projects at once which are difficult for the industry to manage. We continue to be of the view that Ofgem should put more emphasis on prioritising the work that it wants the industry to carry out; take more time to consider the effects of multiple, overlapping system changes and ensure that Ofgem staff are aware of how each other's projects interact. While we welcome Ofgem's commitment to an RPI-X regime, we are disappointed that this has not resulted in a real cost reduction to licensees. We continue to be of the view that Ofgem's staff levels could be reduced without negatively affecting consumers.

Ofgem now has a statutory duty to ensure that it follows the principles of better regulation. Work now needs to be done to demonstrate that Ofgem is putting these principles into practice and we would recommend that measurement tools are developed so that this can be monitored.

We welcome Ofgem's decision to move to 6 week consultation periods. However, we consider that more could be done to improve Ofgem's consultations. A simple step

would be to significantly cut the summary section which is often repeats the introduction. The summary should be no more than one page of A4. The front page should also include when responses are expected; we often have to wade through pages to find the due date. While some of Ofgem's documents are long, they are often very repetitive so we welcome the commitment to make consultations more concise.

We also consider that Ofgem should be clearer about the timing of its consultations. Some documents will appear in the diary for future publication but then "disappear" without explanation. Many publications arrive without any prior warning that they were due for publication. This makes it difficult for the industry to plan its time.

Ofgem needs to make more effort to capture staff knowledge and to ensure that it can demonstrate that it has heard the views of the industry (even when it does not agree). Too much time is taken up repeating positions and views which new staff appear to be completely unaware of, despite previous extensive discussions with Ofgem staff and/or responses to consultations. We also continue to be of the view that Ofgem should spend more time ensuring that it has properly identified a problem *before* trying to develop and implement solutions. Indicators are a good way of identifying whether a problem exists – we remain disappointed that Ofgem has not published conclusions to its gas balancing indicators consultation. It is now over a year late and this would allow all to understand whether, for example, further work on cash-out in the gas market is necessary.

Ofgem continues to use many workgroups to take forward its plans. While this can be a way of opening up the consultation process, the very fact that the groups are open to everyone does not make in itself make the process transparent. This is because there are so many over-lapping groups that it is impossible for anyone except the largest players to attend all of them. Ofgem needs to make more effort to ensure that it has clear communication methods to allow the industry to keep up with discussions. In any case, we consider that there are too many of these groups, on top of the normal industry workstreams and other projects. These are creating inefficiencies within the industry. Ofgem's ability to send several staff to these groups re-enforces our view that Ofgem could make further efficiency savings.

The workgroups should not, and cannot, replace proper consultation. There has been the implication at some groups that since there had been discussion, significant issues would not be subject to proper consultation. This is not appropriate under any circumstance and Ofgem staff should make sure that they are not committing the Authority or any industry player to a position as a result of workgroup discussions.

During the seminar to discuss Ofgem's plan, it was suggested that the Authority meetings should be open and/or minutes published. We would welcome such an approach as we consider that the Authority's decision making lacks transparency.

We also support the suggestion of post-implementation reviews of major projects. We had suggested last year that a review was carried out of the processes leading to the implementation of metering competition. We continue to advocate that this is carried out.

It is welcome that the impact assessments carried out to date have been reviewed. However, we were concerned by some comments made by Alistair Buchanan regarding impact assessments. We consider that it will be necessary for Ofgem to carry these out for some, but certainly not the majority, modification decisions. We strongly urge that a cost-benefit analyses are carried out as part of the impact assessment but this should be done late in the process. It appears that Ofgem has been using impact

assessments as a replacement to consultation documents; ie to prioritise options developed by Ofgem: we do not consider that this was the intention of the Sustainable Energy Act requirement.

Creating and sustaining competition

We agree with Ofgem that the best way to achieve security of supply is through promotion of competitive wholesale markets and facilitating adequate network investment. In order to attract investment to allow Britain's on-going needs for gas to be delivered, it is also important that Ofgem ensures that it is providing a stable, predictable regulatory regime.

We welcome the introduction of timescales on modification decisions as part of Ofgem's performance indicators. We recommend that Ofgem report regularly on how well they are doing to meet these targets at Panel meetings. Ofgem also sets out what it considers its position to be in relation to making decisions on code modification proposals. We consider that the Authority's role should be limited to ensuring that any proposal is in line with the Relevant Objectives of each Code. We do not consider that Ofgem's role should be expanded and yet Ofgem staff have made it clear that it has a specific position on governance of the Code in gas. This appears to us to be beyond the limited role set out in this document and a move away from "lighter touch" regulation. Shippers have been involved in reviewing the Code and raising proposals to improve its governance and we advocate Ofgem remaining in its limited role while this is taken forward.

Ofgem comments on retail and supply markets in its plan. Again, we recommend that Ofgem is clearer about whether it is discussing all supply market issues or just that of the domestic market. For example, the customer transfer project was led by the six major *domestic* suppliers but non-domestic issues did get captured. We will note that for the non-domestic gas market further work on transfers may be required due to data quality issues arising following Ofgem's implementation of metering competition in 2004.

Regulating network monopolies

We consider that the RPI-X regime remains an appropriate incentive-based method to regulate the natural monopolies. This has been reviewed several times since it was first introduced in the gas industry, for example at the time of the review which led to the Utilities Act. We note that this and other reviews have always resulted in keeping RPI-X and see no value in spending significant resources on a further review.

We welcome Ofgem's commitment to apply simple solutions where they are effective. However, we are concerned that Ofgem's approach to introduce different incentives are resulting in extremely complex arrangements for using the network monopolies. We consider that, for the non-domestic sector at least, this is resulting in more significant barriers to entry than the current supply licences. As we have noted previously, there is no evidence yet that the auction process for entry capacity at existing entry points has resulted in any investment signals. We are aware that there is long-term demand for entry; this is a necessary condition for a signal but certainly not a sufficient one. Ofgem wants there to be signals but needs to demonstrate that this can work. The auction approach for entry has already resulted in a move away from cost-reflective pricing; it is important that this principle continues to take precedence over more complex, "innovative" changes. ***Helping protect the security of Britain's energy supplies***

Under “Gas Quality”, Ofgem states that it is possible that in future the EC may seek to harmonise standards. We understand that this is happening. EASEE-gas has developed standards with the support of the Commission.

We note Ofgem’s comments regarding the outcomes of long-term capacity auctions. While we consider to view the auctions as successful in terms of providing some stability to entry prices; it appears that Ofgem wants the auctions to provide signals but is unable to provide any evidence that they have been successful in giving “market signals” for investment, particularly at existing terminals. We continue to view a planning approach as the best practical approach for making investment decisions of natural monopoly assets. We cannot concur with Ofgem’s view that security of supply has been enhanced by the entry auctions as we are unaware of any evidence to support this.

Conclusion

Shell Gas Direct continues to support Ofgem's approach to using markets whenever practical. However, we remain of the view that Ofgem can do more to reduce its role in the competitive market and improve its own efficiency.

Your sincerely

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