Shell Gas Direct Limited

Samanta Padalino
Head of Gas Distribution Policy
Ofgem
9 Millbank
London SW1P 3GE

Direct lines:
Tel: 020 7257 0132
Fax: 020 7257 0101

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Dear Samanta

Structure of gas distribution charges

I refer to the initial proposals document published by Ofgem in July 2005. It outlines Ofgem's proposals to reform the structure of gas distribution charges and seeks views on changes to the capacity and commodity split; updating the Economic Test; CSEP administration charge; customer charge and improved surveys and weighting.

Shell Gas Direct (SGD) is a licensed supplier to non-domestic customers from small commercial businesses to large industrial concerns. We supply both those who have elected to be on firm transportation terms and those on interruptible contracts. SGD outlines below its views on the issues discussed and Ofgem's initial views:

Cost-reflectivity of use of system charges

SGD supports Ofgem's conclusion to not pursue cost-reflexivity requiring the adoption of locational or distance-related charges. We consider that such an approach would have been costly for the industry to implement and unlikely to produce sufficient benefits that would outweigh the costs to consumers.

Even with the separate DN price controls, we are concerned that the "divergence of charges between the eight networks" is likely to introduce costs to suppliers and consumers. It will be important to ensure that this divergence is limited and is on price levels only and not on pricing structures which will further undermine the competitive market. This applies to any of the changes discussed in this document: implementation in the different DNs should be consistent with ensuring the least divergence in pricing structures as possible. This will ensure that the competitive shipping and supply markets can continue to operate efficiently to the benefit of consumers.

Capacity and commodity split

SGD welcomed Ofgem's decision to delay the implementation its proposed changes to the DN interruptions regime. However, we do not support implementation of a new capacity/commodity split *alongside* the implementation of the new interruptions regime. Instead, we advocate that changes to the capacity and commodity split are implemented prior to Ofgem obliges the industry to introduce any changes to the interruptions regime itself. Ofgem states that any increase in the capacity/commodity split “could exacerbate the concerns with the existing interruption arrangements”. We consider it more likely that changing the split will *address* some the issues that customers themselves have raised in relation to the interruptions regime and capacity/commodity split.

We find Ofgem’s IA on the proposed changes to the capacity/commodity split difficult to follow. As Ofgem itself acknowledges, “the form of the new arrangements is not yet known” and it is difficult to see how any analysis could be done to see benefits and costs with or without interruptions “reform”. Changes to the interruptions regime are likely to have significant impacts on shippers, particularly on billing systems, contractual arrangements etc so we cannot understand why a “without” calculation is not provided for shippers. We recommend that a further, separate IA is carried out any proposed changes to the DN interruptions regime.

SGD emphasises that we have supported customers’ initiatives to improve the interruptions regime over the past years. Many aspects have been implemented. We remain concerned, however, to ensure that further changes are detailed and can be shown to improve the regime before any final decision on implementation is made. We note recently an Ofgem advisor raised issues regarding whether a cost-reflective approach could be achieved with 15/30/45 day interruption arrangements introduced.

We are not certain that an earlier issue with interruptible customers on low pressure distribution mains has been considered and should be with any consideration of the capacity/commodity split. We understand that the decision on pipe size for distribution mains may relate to very short (6 minute) peak flow projections[1]. In these cases, it may be that interruptible customers are benefiting from investment in peak capacity.

Out of the options provided, SGD supports moving to 99:1 split. However, we consider that there may be merit in phasing this in with the aim of 99:1 by 2008, in line with the introduction of the new DN price controls. We note again that we see no reason to implement this change alongside changes to the interruptibles regime. Customers already reveal their willingness to pay to be firm but their decision regarding whether what transportation arrangements they choose given the price differential; that is, the customers choose certainty for one price versus an option with an assessment of risk of interruption for a lower price. This differential should be largely cost-reflective and we would assume that moving to a more cost-reflective capacity/commodity split will largely achieve this aim.

We do not consider that the potential for some suppliers to introduce a standing charge to be a barrier to making this change. Standing charges were standard practice a few years ago even with the current capacity/commodity split. Many throughput commodity based pricing regimes have a higher per unit charge for an initial tranche of consumption which is mimics a standing charge in any case. The issue is whether the customer has choice and we see no reason for this change to remove this choice.

The Economic Test

SGD supports Ofgem’s proposal to implement Option 2 to modify the Economic Test (ET) by modifying and updating the ET. We also welcome the requirement to publish the ET. We do not consider that there is a high risk of “gaming” and certainly this risk

[1] See discussion in “Transco Review of Interruptible Services Conclusions and Proposals; Transco Pricing Consultation Paper PC39.”

is more than mitigated by the value of improved information to shippers and consumers. Ofgem suggests that the DNs will be asked to publish a full description of the ET. To ease customers' ability to access the gas networks, it will be helpful if the ET is the same, or very similar, between the DNs.

CSEPs and IGTs

SGD supports the conclusions of the paper prepared by the Gas Forum Suppliers Group regarding issues with supply on IGTs. We consider that the issues discussed here are only a small aspect of the difficulties encountered with IGTs and hope that industry discussions with Ofgem will be able to come up with solutions. We support Ofgem's initial proposal only as so far as the work to improve IGTs' processes and costs are on-going.

Conclusion and next steps.

As Ofgem outlines in this document, it has been some time since the initial consultation and there have been a number of consultations over the years. The changes proposed in this document may have significant impacts on suppliers and on customers. It may be useful to have a more detailed discussion with affected shipper/suppliers before publication of the December final proposals document, perhaps in the form of a short seminar.

Yours sincerely

Tanya Morrison

Tanya Morrison
Regulatory Affairs Manager