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19 October 2005

Dear Mark

Initial proposals on transitional incentives schemes supporting the offtake arrangements

I refer to the above document published by Ofgem in September. It sets out Ofgem's initial proposals on the scope, form and duration of incentive scheme for offtake arrangements for the period October 2005 to December 2008.

Shell Gas Direct (SGD) has a number of concerns regarding the approach Ofgem is proposing to adopt in setting this incentive scheme. Our primary concern is that the proposals within this document appear to us to pre-empt the consultation process we expect Ofgem to follow in setting the next distribution price controls. We would welcome Ofgem's assurance that no decision it makes at this time in relation to incentives will fetter the Authority's discretion regarding the future approach, framework, and associated incentive arrangements which will be developed for the GDPCR.

At the Transmission workstream meeting, Ofgem suggested that it was waiting for responses to this consultation before making its decision on UNC proposal 0046. We would recommend that this proposal is implemented and it should not depend on decisions about licence changes.

We are concerned that Ofgem's proposed review of 1:20 obligations figures could result in an under-investment in gas pipeline infrastructure. While we recognise the requirement to avoid "gold-plating" through over-investment in assets, it should be noted that customers' interests are better protected by ensuring sufficient capacity and the risks associated with under-investment outweigh those associated with over-investment. SGD has attended many meetings where customer representatives have made clear that they consider the cost of some overinvestment to be a price worth paying to avoid underinvestment. We are not clear that this trade-off has been properly assessed and would expect it to be more clearly brought out in Ofgem's forthcoming discussions on the GDPCR.

A particular concern as a shipper and supplier to business customers is the risk that the arrangements Ofgem is proposing could result in volatile transportation prices. While we recognise that Ofgem has introduced licence requirements to minimise the number of transportation pricing changes, we consider that the value of stability of transportation prices contributes to the competitive supply market must be considered when developing these arrangements.

SGD is not clear how the incentive arrangement will work given that it will be based on an outturn price using a methodology that will be reviewed in future and its level will be affected by the outcome of GDPCR. It is not clear to us how the DNs will best be able to meet this target.

SGD recognises the need to ensure the most efficient and economic trade-off is made in incentivising investment in the NTS and the DNs to provide transportation services. An approach needs to be developed to ensure that an efficient trade-off is made. However, we are not convinced that the approach set out in this document achieves this aim. We expect that this will be subject of further industry consultation through the gas transmission price control review and GDPCR. We consider that it would be preferable to set the DNs' incentives in line with the NTS incentives and would recommend that only minimal changes are made at this time. We note that the DNs and the NTS have Gas Act and licence obligations regarding efficiency and meeting reasonable demands of customers.

Yours sincerely

Tanya Morrison
Regulatory Affairs Manager