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Dear Andy

### Re Corporate Strategy and Plan 2006 - 2011

The following comments are offered on behalf of Shell Gas Direct (SGD) in response to the above consultation. SGD is a licensed shipper and a supplier to non-domestic gas customers and these comments are therefore in relation to downstream gas industry issues. While SGD's response to the specific question raised in your consultation document is detailed below, we would like to draw your attention to the following general comments in relation to the use of Impact Assessments and the use of a cost control mechanism in relation to Ofgem's expenditure.

While the use of Impact Assessments (IAs) for significant industry changes per se is a step forward, we would urge Ofgem to remain vigilant in monitoring both the content and quality of each IA. It is important that an IA covers all the relevant issues and presents them in an impartial manner. Similarly, while a cost control mechanism is a useful tool to help limit the regulator's overall expenditure, Ofgem should consider changes to several aspects of the way in which it uses such a mechanism, changes which SGD believes would provide several qualitative benefits.

Ofgem should, for instance, list its planned consultancy budget as a separate figure and one itself subject to a cost control requirement. It would appear that in certain circumstances the use of consultancy support appears to have become an expensive *long-term* replacement for the use of Ofgem staff. Listing the consultancy spend separately would make Ofgem more conscious of the extent to which this was happening.

Ofgem should also indicate the relative importance it attaches to each theme/project it proposes to undertake. An immediate benefit would be to allow market participants to manage the limited resources they can devote to regulatory issues in a more efficient manner.

Moreover, SGD believes that in the event that Ofgem subsequently wished to undertake a project that had not previously been detailed, it should do on the basis of *substituting* it for any of the planned work. Not only would this limit the scope of regulatory activity but also the propensity to spend any of the contingency budget (which we note is due to increase in the period from 2006/7 to 2009/10). Clearly this point would have to be considered within the context of Ofgem being able to carry out its statutory duties. Even if that did become an issue, Ofgem should nonetheless be

subject to the discipline of having to justify undertaking any additional work over and above that originally envisaged. While some may have preferred projects delayed, we consider that the industry would welcome an approach which accepted that not all projects can be delivered according to original timescales as long as this is transparently communicated.

The following comments refer to the specific questions raised in the consultation document.

1. Do the themes remain valid?

SGD believes that to a large extent the themes identified in the consultation document remain valid. However, as noted above, the fact that Ofgem does not indicate the importance it attaches to each theme is a problem. For instance, the present consultation indicates Ofgem will be initiating major change for the coming year, eg. six consultations are to be issued in Q2. It is important to make clear that SGD is not resistant to change per se. Rather, we are very concerned that industry changes should not act to increase the complexity and operational costs of the regime.

The level of increased complexity and uncertainty can act to reduce effective competition and we remain unconvinced that Ofgem has fully understood these issues. As has been pointed out on previous occasions, much of the work for shippers and suppliers in implementing costly and complex changes in the gas and electricity industries occurs only after Ofgem has made its final decision. Notably, these changes affect our IT systems and may require changes to contracts. However, Ofgem appears to consider that there is “breathing space” at these times in which it can launch further projects and consultations. It must be noted that even if the projects are initiated by different teams within Ofgem, they will impact our systems and processes equally.

SGD notes that the introduction of the Reform of Gas Metering Arrangements (RGMA) and the new regime to accommodate National Grid’s sale of four of its distribution networks to demonstrate the above concerns. Reforms in one have been undertaken without reference to their impact on the other, a cause of concern to SGD and, we believe other market participants.

Additionally, it should be pointed out that the sheer volume and complexity of changes brought about by Ofgem appears to be having a detrimental effect on Ofgem staff, some of whom are unable to appreciate the impact of Ofgem policy initiatives outside their very own narrow area of work. It would be beneficial for Ofgem to promote greater interaction and exchange of views in order to understand the effect and relationships between each consultation.

2. Have we identified all the relevant issues within each theme?

The consultation illustrates a number of relevant issues. However, as they are continually changing, the document is merely a snapshot of current relevant issues of which Ofgem needs to remain aware. By way of example, SGD would ask why Ofgem has indicated the need for a review of Reconciliation by Difference (RbD)? Should any party have wanted to review RbD, this could have been done via a modification as this would be better steered by the industry rather than Ofgem.

The broader issue of code governance is also a concern. We do not believe that we are the only market participant concerned with the way in which Ofgem dealt with the raft of modification proposals connected with emergency arrangements for winter

2005/06. SGD believes that urgent treatment of a modification proposal is no substitute for careful planning and thorough consultation and is further concerned at Ofgem's use of its powers to disallow the right of appeal in respect of two of proposals related to the emergency arrangements for this winter. We have previously suggested that the arrangements and Ofgem's approach should be subject to independent review and remain of this view. Shell takes security of supply issues seriously: our concern is that the new arrangements have undermined the safety of the arrangements instead of enhancing them.

SGD notes that Ofgem is proposing further evolution of metering policy. Whilst supporting the introduction of smart metering in principle, competitive metering arrangements themselves are at a relatively immature stage. They should therefore be allowed to develop further and understood by all, not least by Ofgem, before contemplating any further complications.

3. Is Ofgem's approach to the challenges ahead the right one?

SGD very much believes that a key task for Ofgem is to ensure that it develops a light-touch regulatory approach wherever possible, in reality and not name only. The first question Ofgem should ask itself is: Why should Ofgem be involved? As such, before embarking on any initiative, Ofgem should concentrate on justifying its actions by asking whether they are: beneficial to the customer; necessary; and if so, are they necessary now?

SGD believes that in a competitive market, much of Ofgem's work should be reactive in nature. As such, Ofgem should therefore limit itself to facilitating discussion and allow the energy market to operate in the same manner as other competitive markets. At present, however, Ofgem takes a proactive approach to its participation in a competitive market and this manifests itself in the large number of Ofgem workgroups, workstreams, seminars etc, leaving few, if any, parties (including Ofgem) with a sufficiently robust overview of the extent of industry change. Some of Ofgem's workgroups replicate established workstreams making it a proactive initiator of change, which is not consistent with Ofgem's aim of light touch regulation. This disproportionately impacts smaller market participants who are unlikely to be able to justify the amount of regulatory resource required to respond to all developments that may materially impact their organisation.

We consider that a stable investment climate is key to ensuring on-going security of supply through diverse sources of gas. We continue to believe that we had a regime that was sufficiently robust for dealing with any potential difficulties. It is important for Ofgem to demonstrate its confidence in the market by allowing it to work. Further, in areas such as the Winter Outlook reports, Ofgem needs to find a more inclusive approach ensuring that shippers, suppliers, consumers and transporters are involved before policy decisions are made.

4. Are there any licence conditions or other obligations that impose an unnecessary administrative burden?

SGD believes that Standard Condition 25 of the Supplier Licence on efficient use of gas should be removed. While acknowledging the importance of the issue of energy efficiency, we believe that this licence condition replicates the work being done by the Carbon Trust et al.

The priority for the Authority should continue to be to transform Ofgem into a reactive regulator in reality. This means concentrating on areas where ongoing work is necessary (such as price controls), investigating where complaints have been made and deciding on whether to approve (or not) changes proposed by the industry in line with its Gas Act responsibilities.

Logically, the successful introduction of competition in supply and shipping should result in Ofgem being able to withdraw more from any proactive intervention in the market and its development, and allow for the reduction in staffing levels.

Yours sincerely

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