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Dear Robert

Re Proposed Incentive Arrangements for the Provision of NTS Entry Capacity at Milford Haven

I would like to offer the following comments on behalf of Shell Gas Direct (SGD), the holder of both supplier (non-domestic) and shipper licences, in response to this consultation.

Should new incentive arrangements for National Grid Gas NTS be developed in relation to the delivery of gas transmission capacity for Milford Haven?

As a general point, SGD does not believe that the current regulatory arrangements, which involve system users picking up a proportion of buyback costs, provide the most efficient incentives on NGG NTS to invest in an efficient and timely manner. Indeed, that aspect of the current arrangements can only lessen such incentives, hence the need for this consultation. Instead, Ofgem should give consideration to NGG NTS being required to enter into a direct contractual relationship with its counterparty, with any liabilities for the non-provision of capacity to be agreed and contained in a bilateral agreement, and the regulator acting as a dispute authority. That may be something to consider as part of the current price control review.

However, given the current regulatory arrangements, any limiting of shippers' exposure to buyback costs is to be welcomed. In saying that, it should not be forgotten that the potentially **very** significant increase in buyback costs at Milford Haven has arisen within the context of regulatory arrangements devised, approved and, it must be assumed, monitored by Ofgem.

Therefore, asking for views on an appropriate buyback mechanism fails to address two other potentially relevant issues: Ofgem's monitoring of the monopoly transporter's activities in relation to these arrangements; and Ofgem's initial views as to whether NGG NTS might be in breach of any of its licence conditions. If nothing else, this might help inform the debate on future incentive arrangements.

Are the principles identified in paragraph 4.3 an appropriate basis for new incentive arrangements?

SGD would expect that *any* incentive arrangements should incorporate the principles contained in para 4.3. The implication of the question is that they should only apply at Milford Haven.

In relation to the third bullet point, SGD would urge Ofgem to recognise that any concerns regarding business risk and cost of capital do not apply to NGG NTS alone. Shippers will face exactly the same concerns.

SGD notes Ofgem's comments in the fourth bullet point regarding '..a stable regulatory framework that promotes investment in the gas supply chain, including LNG import facilities.' It is to be hoped that Ofgem bears this mind in relation to the proposed NTS entry and exit reforms.

Should National Grid Gas NTS be shielded from buyback costs if there are undue delays in the DTI giving consent for the construction of the reinforcement pipelines, adverse weather conditions or other exceptional factors?

NGG NTS decided to proceed with its investment plans on the back of the results of the September 2004 QSEC auctions. Given that these auctions signalled demand of 350GWh/d from October 2007 onwards, a figure in excess of NGG NTS' own initial demand forecast of 200GW/d, NGG NTS must surely have considered that this figure could have continued to increase in the December 2004 auctions, and discussed the potential impact with the developers and Ofgem?

If NGG NTS' decisions have subsequently led to the need to seek an alternative pipeline route that may involve delays of the type suggested in the question, any resulting buyback costs should reside with the monopoly transporter.

What are the advantages and disadvantages of the new incentive arrangements described in this chapter?

SGD assumes that the figures quoted under the various options have been calculated on the basis of the conclusions of the report from Deloittes. Without having seen this report, we feel unable to be precise regarding the merits of one option over another.

However, it could be argued that it would be preferable to opt for profiling NGG NTS' buyback exposure towards those periods when the buyback costs could reasonably be expected to be at their highest. However, this consideration needs to be weighed against the possibility that under any profiling option the monthly cap on NGG NTS' liabilities could be breached, thus exposing system users to buyback costs sooner rather than later.

Are there any further steps that should be taken to encourage National Grid Gas NTS and the relevant shippers to enter into arrangements that would minimise the economic costs of any delay in the provision of transmission capacity at Milford Haven?

It is not clear what more the relevant shippers could do. SGD's reading of the document is that they acted in accordance with the arrangements, so any further steps should be in relation to NGG NTS exposure.

In justification of the proposed exit reforms, Ofgem staff have pointed to the 'overbuilding' of entry capacity by NGG NTS prior to the introduction of the entry auctions. If this is indeed the case, perhaps Ofgem should give serious thought to netting-off the resulting revenues received by NGG NTS against any buyback costs at Milford Haven?

Conclusion

SGD believes that the present incentive arrangements remain inappropriate and place far too much risk on system users as opposed to the monopoly transporter. Unfortunately, the various options put forward in the document compound this state of affairs. For example, NGG NTS' liabilities would be a maximum of £36m and yet the costs of economic disruption are quoted as potentially being between £100m to £300m.

It is not clear from the document whether Ofgem thinks NGG NTS could have done more to have avoided this situation; and whether it was acting prudently, economically or efficiently. NGG NTS clearly had doubts at an early stage about being able to provide the necessary reinforcement, so it seems surprising that they went ahead on the basis of the September 2004 auctions which showed that demand was *increasing*.

To the extent that, for whatever reason, the potential level of buybacks has now increased, nothing in this document leads SGD to conclude that the bulk, if not all, the costs should be faced by NGG NTS. The relevant shippers should not be disadvantaged and nor should other system users.

I hope these comments are helpful. Please do not hesitate to contact me should you have any queries.

Yours sincerely

Amrik Bal
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