

**Shell Gas Direct Limited**



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Dear Joanna

**Gas Distribution Price Control Review – Third Consultation Document.**

Thank for the opportunity to comment in response to this consultation document. Shell Gas Direct Ltd's answers to the specific questions posed in the document are provided in Appendix 1. Also included in the appendix are other more general comments that we hope you find useful.

If you or your colleagues have any queries regarding any aspect of this response, please do not hesitate to contact me. In the meantime, kindly note that this is a non-confidential response and so may be placed on your website.

Yours sincerely

A handwritten signature in purple ink, appearing to read 'Amrik Bal', is located below the 'Yours sincerely' text.

Amrik Bal  
**UK Regulatory Affairs Manager, Shell Energy Europe**

## Appendix 1 – 3<sup>rd</sup> GDPCR Consultation Document: SGD Response and Additional Comments

	<b>Doc Ref</b>	<b>Issue</b>	<b>SGD View</b>
	Comment – see para 1.6	Ofgem believes that the creation of separately owned, managed, and operated GDNs will allow more effective comparisons to be made between the businesses, building on the sense of rivalry which exists between independent management teams.	Separately owned businesses should allow for more transparency of costs and easier analysis of business practices, which should in turn allow greater efficiency drives in future price controls. However, similar objectives could have been achieved through the requirement for greater levels of reporting and information disclosure
	Comment – see para 1.7	Ofgem putting in place a cost reporting framework	SGD supports this, but in order to be effective, this cost reporting framework must be robust and allow for the capture of comparable costs.  There is also a substantial delay before customers see any benefit from the use of data extracted via this framework – reference to future price reviews is made suggesting the earliest benefit could be April 2013
	Comments – see para 1.8	Changes to interruption arrangements and for NTS offtake capacity trading by GDNs will be introduced during the price control. Ofgem will manage interactions between these projects.	SGD has been critical of many of Ofgem’s proposals in this regard and is not surprised at the predictable delays in implementation. For example the regime for DN Interruption is not yet finalised despite the implementation date being expected to be 1 <sup>st</sup> April 2007.  However, notwithstanding this view,, as a general comment we would state that minimisation of risk is vital to the efficient operation of the market. Therefore, there should be as much certainty as possible about arrangements that will be altered/introduced in the course of the price control.
<b>Ch 2</b>	<b>Q 1</b>	“Do you agree with our initial views on which services could be given excluded treatment? Are there any additional services that we have not considered?”	SGD has nothing to add other than to say we tend to agree with Ofgem’s thinking on excluded services.
	<b>Q 2</b>	“Should domestic one-off connections be treated as excluded services or ordinary price control services?”	We endorse bringing these into the price control with a revenue driver linked to connection volumes. This would protect the interests of consumers in line with Ofgem’s primary objective. We believe that this supports the economic and efficient operation of the system and appropriate cost recovery.

	<b>Doc Ref</b>	<b>Issue</b>	<b>SGD View</b>
	Comment -see para 2.13	Risk of MAMs procuring metering services from parties other than GDN will lead to GDNs having stranded opex with regard to their emergency services.	<p>This is a commercial risk that results from the introduction of metering competition. However, the only realistic manifestation of this risk would be where a GDN has substantial volumes of meters to maintain, and hence supported a large workforce, but where due to reduced numbers the reduction in workforce would no longer support their emergency obligations. This is not a scenario that is likely to happen in the short term and the sold DN will not have sufficient meters to be in such a position nor will the major provider of meters sell their assets to place themselves in such a predicament.</p> <p>Therefore, we do not support any allowance for this.</p>
	<b>Q3</b>	“Have we correctly identified the range of items that could be treated as pass through items? Should these items be treated as pass through items	SGD supports Ofgem’s position on pass through costs.
	<b>Q4</b>	“Is there any reason why we should change our position on cost indices?”	No.
	<b>Q5</b>	“Is there any reason why we should change our position on re-openers?”	No.
	<b>Q6</b>	“Should we introduce a two-tier correction mechanism for over and under recovery of allowed revenue, consistent with the arrangements that apply in electricity distribution?”	This is an area where consistency between electricity and gas arrangements could be beneficial. However a cost benefit case would need to be made to support the additional complexities
	<b>Q7</b>	“Should we calculate the GDNs’ allowed revenues in a way that creates a smooth revenue profile over the course of the price control period?”	<p>SGD is not convinced that a smooth revenue profile brings any benefits, particularly given the industry changes scheduled to occur in the course of the price control. Sufficient price certainty is provided by the price control. The effect of smooth revenue profile could increase the overall risk profile of the market by further separating the revenue streams of shippers from those of the GDNs.</p> <p>We do not support changes to the current calculation system or timing.</p>
	Comment -see para 3.13	Ofgem planning substantive update of its benchmarking analysis once figures for 2006 -07 becomes available.	SGD suggests that this becomes an annual activity over the lifetime of the price control period, so that data can be analysed in a timely fashion and is sufficiently graduated. Over a period of time, there should be a gradual fall-out of start-up costs, thus allowing for an accurate view of operational costs.

	<b>Doc Ref</b>	<b>Issue</b>	<b>SGD View</b>
<b>Ch 3</b>	<b>Q1</b>	“Is our proposed approach to setting capital and replacement expenditure allowances for 2008 -09 to 2012 -13 appropriate?”	It is difficult to state without further details of the analysis to be published in March (although the techniques employed in this analysis seem reasonable) and plans for non-operational capex.
	<b>Q2</b>	“Is our proposed approach to setting opex allowances for 2008 -09 to 2012 -13 appropriate?”	Ditto.
	<b>Q3</b>	“Is our proposed approach to updating the GDNs’ RAV to 1 April 2008 appropriate?”	SGD supports this at this stage, although the absence of any details until September 2007 leads us to caveat this position until details are available. A concern is that the GDNs will seek to increase their RAV partially to compensate for overpaying for the purchase of the assets

	<b>Doc Ref</b>	<b>Issue</b>	<b>SGD View</b>
<b>Ch 4</b>	<b>Q1</b>	“Do you support the proposed changes to the quality of service outputs?”	<p>We welcome Ofgem’s programme of consumer research, and we look forward to the outcome of this research determining quantifiable and qualitative service measures for GDNs to operate against. In the absence of the analysis, it is difficult to confirm support for any specific proposals. It is our position that ‘Do Nothing’ is not a viable option for the reasons mentioned in the consultation. We are cautious, however, about introducing a revised regime unless it is done so taking account of consumer concerns, otherwise the new regime could prove as unfit for purpose as the current one.</p> <p>We would support the introduction of Guaranteed Standards to replace Overall Standards, to be enforced with appropriate incentives. The details of the changes and the incentives should be informed by the outputs of Ofgem’s consumer research, though the Guaranteed Standards on Suppliers offers a reasonable framework which could be applied to GDNs.</p> <p>We would support the simplification of reporting where possible, and anything that ensures consistency of reporting across GDNs is to be welcomed.</p> <p>We believe that new financial incentives alongside Guaranteed Standards would result in the necessary performance improvements. We are not convinced of the merits of revisions to the licence conditions at this time.</p>
	Comment – see para 4.56	Ofgem propose that new SI cross-references with UNC	<p>SGD is not supportive of the concept of linking the SI to specific elements within the UNC. The UNC is a consequence of the legislation and it seems a little circular to then have legislation referencing part of the UNC. This doesn’t even take account of the difficulties associated with version controlling two linked documents subject to different governance as already experienced between UNC and SPAA – an acknowledged problem.</p>

	<p><b>Q2</b></p>	<p>“Do you support the proposed changes to third party damage and water ingress proposals?”</p>	<p>We support the changes regarding the introduction of a Guaranteed Standard that would see consumers compensated in this scenario, with incentives to ensure the timely reconnection of consumers.</p> <p>We are not convinced that UNC is the correct place for compensation to non-domestic consumers to be set out as this is a GDN-Shipper contract. We would prefer that this was included in new Gas Standards or in the GDN licence.</p> <p>We agree with the reduction of the event cap as proposed by Ofgem as long as this is reflected in a lower opex allowance.</p> <p>The alignment of GDNs' limitation of liability with that of electricity DNOs appears sensible assuming that the rates of occurrence and costs to restore are broadly similar</p> <p>IGTs should be subject to similar standards to the GDNs.</p>
	<p><b>Q3</b></p>	<p>“Do you support our proposals for improving the accuracy of pipeline records?”</p>	<p>As Ofgem notes, this has been an issue for some time. SGD is very much in favour of any proposals to improve GDN record keeping and accuracy. However, it should be recognised that failure to maintain such records is a breach of a GDNs licence.</p> <p>The issue more precisely relates to the definition of accuracy and timeliness of recording and updating.</p>
	<p><b>Q4</b></p>	<p>“Is it appropriate to introduce network capacity output measures? If so, what type of output measures are appropriate and what sort of rewards/penalties should the GDNs be exposed to?”</p>	<p>We share Ofgem’s concerns of the need to ensure that GDNs are not compensated twice for the provision of the same capacity, and we are concerned that use of the licence conditions alone is insufficient to provide the appropriate clarity to incentivise capacity investment. We would prefer supply and demand investment scenarios to be developed so that this clarity is provided. Incentives could then be put in place to ensure that the GDN operates in line with those scenarios. We are concerned that putting a very detailed scheme in place could end up having perverse consequences. We would counsel a staged approach, introducing a scenario-based framework at this point. More detailed standards could be introduced if it was found that the framework was not sufficient</p>

	Comment – see para 4.72	Measuring and incentivising long-term network performance	The long term measurement and incentivising of network performance is difficult to achieve and generally only possible to prove after the asset has deteriorated. A more reasonable approach linked to network capacity would be to make the financial consequences of failing to sustain network performance through an asset failure larger than the saving arising from the conditions that led to the asset failure.
	Comment – see para 4.79	Views on a more proactive riser replacement policy	<p>We would welcome a more proactive riser replacement policy. We suggest that in each case, a cost-benefit study is carried out before replacement work commences to identify the most cost-efficient solution. As each case will be very different, this seems to us to be the most sensible solution, and will allow each of this limited number of cases to be dealt with appropriately by the GDN in conjunction with suppliers where it may be best to switch customers completely to electricity.</p> <p>A specific licence condition appears to be a blunt instrument in this case. A process similar to that for determining the policy replacement of pipes could be adopted backed up by a general licence obligation</p>
	Comment – see para 4.82	Ofgem would welcome views on whether it is necessary to do more to facilitate the adoption of private networks by GDNs	We are not convinced of the requirement for further work to be done on this area at this time. It appears to be of a low materiality. The best solution may be to exclude adoption of private networks from the price control until the next RAV review to support the price control from 2013.
<b>Ch 5</b>	<b>Q1</b>	Have we identified all of the issues for each of the incentives?	Until the completion of the consumer survey and the presentation of the analysis, we are hesitant to state that all issues have been identified. At this point, we have no further issues to add
	<b>Q2</b>	Is it appropriate to better align capex and opex incentives?	We believe that better alignment of capex and opex is appropriate and will be beneficial if underpinned by annual cost reporting and benchmarking across GDNs to ensure consistency across all operators. Benchmarking will be vital to ensuring that no perverse incentives arise for any GDN, and will allow for a better-focussed price control from 2013. It may be possible to introduce a rolling opex incentive from 2013 on this basis.

	<b>Q3</b>	Do you agree with our initial view that a capex rolling incentive and information quality incentive should be implemented?	In principle, we agree with Ofgem's initial view, though we cannot commit to absolute support until the publication in March of the details of the information quality incentive. We would also reserve absolute support for any incentive pending the publication of the analysis of the consumer survey.
	<b>Q4</b>	Given the issues raised is there a case for an opex rolling incentive?	We do not believe that there is a case for an opex rolling incentive at this time. Through the information quality incentive and annual reporting and benchmarking of costs, it may well be that such an incentive could be introduced in the 2013 price control.
	<b>Q5</b>	Do you agree with our proposals to retain the mains replacement incentive?	<p>We believe that the mains replacement incentive has been successful and agree that it should be retained with the addition of service pipes.</p> <p>We share Ofgem's view that inclusion of risers in the allowance for mains replacement would be inappropriate.</p>
	<b>Q6</b>	Is flexibility capacity the key incentive to focus on for the capacity outputs? Should we assume that the use of existing NTS flex capacity is the most efficient flexibility product?	In the NTS exit reform debates we have been and remain far from convincing for the case for flexible capacity. Our position is much the same in this price review.
	<b>Q7</b>	Is it appropriate to assume that NTS and LTS flat capacity are complementary products? Should we incentivise tradeoffs between flat capacity and interruptible capacity?	<p>We believe that it is appropriate to assume that NTS and LTS flat capacity are complementary products.</p> <p>We do not believe that incentivising trade-offs between flat and interruptible capacity is appropriate at this time; the market can be trusted to set an appropriate price for interruptible capacity.</p>
	<b>Q8</b>	Should we incentivise accuracy of pipeline records? If so, how could accuracy be measured and audited?	<p>We are very much in favour of incentivising accuracy of pipeline records. We believe that data quality is a matter of utmost importance with implications for consumers' experience, and in extreme cases, for safety. We would expect standard data quality measures to be used, including:</p> <ul style="list-style-type: none"> <li>• availability</li> <li>• Completeness</li> <li>• validity</li> <li>• redundancy</li> </ul>

			<p>We would expect GDNs to have audit trails for data from first entry on the system to storage and eventually archival. We believe that there should be an audit of records carried out periodically and this should be reported to Ofgem.</p> <p>Guaranteed Standards about data quality should be introduced so that customers are compensated if their valid complaints are found to be the result of data inaccuracy in the GDN's system.</p>
	<b>Q9</b>	Is there a case for an innovation funding incentive?	We share the view that significant innovation takes place under the existing price control regime. We do not believe that the case for an innovation funding incentive is robust.
<b>Ch 6</b>	<b>Q1</b>	Should we allow for an ex post adjustment for changes in tax treatment of certain kinds of expenditure, as outlined in paragraphs 6.3 and 6.4?	<p>In the instance of such a change in tax treatment seriously disadvantaging a GDN, it would be appropriate to consider reopening the price control if all reasonable steps to mitigate the impact could be demonstrated to have been taken and failed.</p> <p>However, as there currently exists the opportunity for a GDN to request the re-opening of a price control during the period of its operation should there be a significant event, could not changes in taxation of the suggested scope be tackled under such a regime?</p>
	<b>Q2</b>	Which key ratios should we use as financeability indicators?	A combination of the DPCR4 ratios with those used by the rating agencies appears sensible.
	<b>Q3</b>	How should we finance replacement expenditure, having regard to its impact on the overall financeability of the price control?	We are not convinced of the case for changing the existing practice with regards to financing replacement expenditure. We therefore recommend continuing with the current practice.
	<b>Q4</b>	Should we change our depreciation rate for new assets in response to the changing mix of assets being capitalised?	We do not believe that it is appropriate to change the depreciation rate at this time. We do not believe that the increased IS costs will be sufficient by comparison to the value of the network for this to be an appropriate solution.
<b>Ch 7</b>	<b>Q1</b>	Which of the two forms of the network extensions incentive scheme should we adopt going forward?	We believe that Option 3a aligned with Option 6 is the best network extensions scheme as it allows incentives to be operated flexibly and avoids perverse incentives. Amending the economic test to allow for fuel poor communities seems to allow the best alignment of incentives and objectives.

	<b>Q2</b>	Do you agree with our assessment of the risks, costs and benefits attributable to the options for facilitating network extensions (see Appendix 6)	While the initial impact assessment offers a useful helicopter view, we believe that further analysis is necessary before it will be possible to correctly assert the risks costs and benefits attributable to the options.
	<b>Q3</b>	Is our proposed methodology for quantifying the costs and benefits associated with the various options appropriate (see Appendix 6)?	The proposed methodology appears appropriate.
	<b>Q4</b>	Is it appropriate to set an incentive scheme, which recognises the initiatives that some companies undertake with respect to their corporate social responsibilities?	We believe that it is appropriate to undertake an incentive scheme along the lines of DPCR4. It is our position that such a scheme will encourage best practice across all GDNs.
	<b>Q5</b>	What other criteria should be included in a Corporate Social Responsibility incentive scheme for GDNs?	We would be interested in GDN's views on this matter.
<b>Ch 8</b>	<b>Q1</b>	Do you agree with our assessment of the risks, costs and benefits attributable to the two options for the funding of xoserve?	<p>We are not convinced of the benefits of Option 2 or of the negative analysis dealt to Option 1. We do not share Ofgem's view that Option 2 incentivises GTs to be more responsive to customer needs. Further analysis on how such a culture change could take place is required, but we do not believe that a change in the xoserve arrangements alone will suffice.</p> <p>Further, any benefits to Option 2 are completely dependent upon the split between core services and user pays. In the absence of a proposal, it is difficult to envisage how realistic these costs and benefits will prove.</p> <p>We do not accept that shippers would make a commercial decision to submit poor data to xoserve due to xoserve's funding arrangements. Shippers and suppliers are reliant upon data quality for the operation of their business. We are concerned that shippers could be forced to pay for the cleaning of the data historically provided to them by the GTs if a user pays system were adopted for the enquiry line. The provision of poor data starts with the owner of or party responsible for that data. This is almost never the shipper and so any proposal for the shipper to pay to try to resolve data discrepancies clearly misses the point.</p>
	<b>Q2</b>	If we adopt a core services plus user pays approach (Option 2), how should we define core services and user pays services?	In principle, all regulated services should be treated in a similar fashion. It is difficult to ascertain what could be held to be a non-core service if it is a service that must be regulated,

			<p>and is therefore being held to be non-contestable. These costs must be recovered through the price control.</p> <p>We do not accept that there are poor incentives on shippers to limit the costs that they impose on xoserve. Any proposed changes to the regime must be supported by a robust cost-benefit analysis and appropriate governance arrangements.</p> <p>We accept that any non-ASA service requested by a shipper, or indeed another party should be ring fenced, costs recovered on a user pays basis by xoserve and should be excluded from the price control.</p>
	<b>Q3</b>	What costs/benefits would your organisation incur in the event that we adopt Option 2?	It is difficult to gauge this without further detail/analysis being made available on the proposals. However, we would expect the current provisions to continue as core functionality covered by the price control.
	<b>Q4</b>	What questions do we need to ask GTs, xoserve and shippers in order to accurately quantify the costs associated with Option 2?	<p>It is difficult to gauge this without further detail/analysis being made available on the proposals. It is important that whatever scenarios are envisaged do not discriminate between domestic and non-domestic customers.</p> <p>A key issue to be addressed would be the costs of any new governance arrangements required to support user pays services.</p>
	<b>Q5</b>	<p>In the event that the Secretary of State requires GDNs to put in place further alternative arrangements relating to independent systems, should the excess costs associated with independent systems be:</p> <ul style="list-style-type: none"> <li>• spread across all GB consumers via transmission charges; or,</li> <li>• borne by customers located in gas distribution areas where independent systems are located (primarily Scotland)?</li> </ul>	<p>We are not satisfied that such an event should trigger a reopening of the price controls. Should any such hypothetical event take place the transporter has the option of seeking to re-open the price control or waiting until the next price control review to seek under recovered costs.</p>