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03 April 2007

Dear Richard

**Charging Arrangement Associated with Methodologies for the Determination of NTS Entry and Exit Capacity Price (Impact Assessment, Ofgem, 6 March 2007)**

Shell Gas Direct Ltd (SGD) welcomes Ofgem's decision to conduct an Impact Assessment (IA) with respect to GCM01. The nature and wide-ranging implications of this pricing consultation merit such a decision.

SGD, the holder of both gas supply (non-domestic) and shipper licences, offers the following comments.

**Chapter 3**

*Question 1*

*Do respondents have any views on the appropriateness of the transportation model given the relevant objectives specified in NGG's gas transporter licence?*

As a general comment, we would suggest that criticisms of one engineering model, ie. Transcost, do not necessarily mean that an alternative engineering-based tool may not be an appropriate means of determining NGG's costs. The issue may be more one of an improved engineering-based approach rather than a different methodology entirely.

In that context, we note Ofgem's view in relation to the transportation model that:

*'...it would be difficult to determine whether charges calculated using the transportation model would, in absolute terms, be more or less cost reflective compared with the charges currently in place.'* (para 3.11)

To the extent that the transportation model might provide better locational signals and that it is important that relative prices are correct – given that we are talking about a natural monopoly, we would argue that absolute prices are just as important – discussion of the NTS short haul tariff would have been beneficial. Wasn't this tariff meant to deal with the situation of NTS exit points located close to NTS entry points?

Given the above and our answers to the various issues raised in Question 4, we have yet to be convinced that the transportation model does:

- a) reflect the costs incurred by NGG in its transportation business; or

- b) facilitate competition between gas shippers and gas suppliers.

### **Question 2**

***Do respondents wish to present any additional analysis that they would consider relevant to assessing the proposal?***

We have no further analysis that we wish to present.

### **Question 3**

***Do respondents consider that there are any aspects of the proposal that have not been fully assessed?***

As we explain in our answer to Question 4, we consider that there should be a more detailed cost/benefit analysis in relation to backhaul flows and spare capacity.

On a related note, there appears to be no consideration given to the different nature of the new supply sources coming in at the more westerly and south-easterly parts of the NTS. A lot of the backhaul 'benefit' seems to be predicated on gas flows that could just as easily be diverted to other markets. Would this have an impact on an assessment of the backhaul aspect of the transportation model?

Further details of the likelihood of underutilised assets would also have been beneficial. This is important given the impact this could have on consumers.

### **Question 4**

***Do respondents have any specific views on the (i) exclusion of spare capacity in the model; (ii) inclusion of backhaul into the model; and (iii) inclusion of only a single expansion factor into the model; and given these features of the proposed model whether the proposed model is an improvement compared with the current model (Transcost)?***

It is not clear why there should be difficulty in identifying spare capacity, be it permanent or not; SGD would welcome further clarification on the difficulties in doing so. This is important because we would have assumed that Ofgem, on a point of principle, would want the monopoly transporter to make all capacity available?

We note the view expressed by one respondent to NGG's original consultation that including spare capacity could mean a significant shortfall in auction revenue. The question for Ofgem is whether the certainty of auction revenue is more important than making all capacity available?

In isolation, the inclusion of backhaul would appear a progressive step. However, while we appreciate that backhaul flows can reduce the need for system reinforcement, there is nothing in the document that demonstrates: a) the reliability of such flows; and b) how easy or not it would be to quantify the benefits of avoided costs?

In short, therefore, a cost/benefit analysis of the inclusion of backhaul flows at the expense of including spare capacity is required. This should include the impact that the exclusion of spare capacity could have on new entrants, along with the additional potential impact on security of supply (see response below to Q1, Chapter 4).

We also question whether a single expansion constant determined from the average cost of capacity for 900mm, 1050mm and 1200mm pipeline can cost described as cost reflective? It is difficult to see how this could be the case if it is an *average*.

#### **Chapter 4**

*Question 1 Do respondents have any views on the additional analysis set out in this chapter?*

#### Security of Supply

We have made clear our views to Ofgem previously and surprised that this issue has not been discussed in greater detail. By way of summary, however, it is worth stressing that the transportation model could make it more difficult for the further development of mature and new UKCS fields. Despite declining UKCS production, this source will continue to play a crucial role in our gas supply mix and security of supply.

Moreover, it could put GB at a disadvantage in attracting other reliable North Sea supplies. This would especially be the case if there were alternative and competitively priced nearby markets.

Please note that we have no comments to make in relation to Questions 2 and 3.

As a final comment, we would suggest that Ofgem considers whether Users of the NTS are able to comment with any great expertise on the detailed technical and network assumptions that underpin a shift from one model to another? Much of the expertise lies with NGG and some thought should be given to an external technical audit of NGG's modelling and assumptions.

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

Yours sincerely



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