Shell Gas Direct Limited

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Dear Sonia

National Grid Transco – Potential Sale of gas distribution network businesses and appendices

I refer to the two documents published by Ofgem in November 2004 as above. We understand that Ofgem considers these to be final of its impact assessment documents. I attach Shell Gas Direct's response and summarise our key points below.

The sale of distribution networks (DNs) by National Grid Transco (NGT) and the changes to the structure of the industry associated with this, will be the most significant change to the industry since the introduction of the Network Code. There are extensive areas with issues still to be resolved and work still under way: we consider that Ofgem will need to do further final impact assessments notably on its proposals on the exit and flexibility regime once these are developed sufficiently, to ensure Ofgem's compliance with its requirements under the Sustainable Energy Act.

We understand that Ofgem will be preparing brief overviews of responses for the Authority. We have prepared a synopsis below. Given the importance of its decision, we assume that the Authority will take all necessary steps to ensure that each member is fully informed of the issues raised and risks associated with this project before making its next decision.

Précis of SGD's response

Shell Gas Direct (SGD) reluctantly considers that the "no sale" option must be chosen at this stage given the high degree of risk associated this project in its current stage of development. In principle we do not object to the sale and consider that a robust "sale" option could be developed in 2005. We are concerned that the analysis of costs and benefits with the "sale" option presented is optimistic and disregards key cost implications, notably in relation to metering and data quality. We remain concerned that Ofgem has not followed robust processes in progressing this project. Issues previously raised concerning the Authority's Gas Act obligations in respect to the principles of best regulatory practice should be addressed explicitly. We are disappointed that no member of the Authority has been willing to meet with industry participants throughout this process. Ofgem has added unnecessary complexity to this project particularly with the inclusion of changes to the exit regime and introduction of the flexibility arrangements. Undue discrimination appears to be a recently developed reason to introduce proposals previously advocated by Ofgem. Ofgem has a duty to consumers to ensure that this project is implemented well and responsibility for ensuring the NGT is not taking advantage of its position while taking its project forward.

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Summary

- SGD continues to have no objection to the sale of the DNs. However, we remain of the view that the approach adopted by Ofgem and NGT is likely to increase unnecessarily initial and on-going costs of this change. For this reason, we consider that the “no sale” option should be adopted at this point. This project involves, in effect, today’s consumers (through their shipper/suppliers) making an up-front loan of an uncertain size for the initial costs of the DN Sale in the expectation that future consumers will be paid back at some unknown rate starting sometime *after* the next price control period.

- We consider Ofgem’s analysis of the potential net benefits to be optimist, not conservative. More effort should be made to risk the potential outcomes.

- SGD has not submitted costs on exit and flexibility products as the proposals were (and remain) too poorly developed to do proper costings[1]. We consider any costings in this area at this time to be at best preliminary given the state of developments on this, separate, project. A further, full RIA on exit and flexibility will need to be done. Changes to the exit regime will have a significant impact on NTS customers. To the best of our knowledge, Ofgem has not sought information from these customers regarding costs. It is imperative that this information is included before any final decision is made.

- There are many areas where there costs will increase directly as a result of the sale which have been disregarded, minimised or not fully understood by Ofgem.

- The inclusion of an agency will mitigate some problems which will arise with customer transfers. It does not remove them and the risk of a negative impact on customer transfers cannot be ignored. We remain concerned that the combined effects of the introduction of RGMA in 2004 and the DN Sale in 2005 could lead to significant problems with data quality. The additional impact of the DN Sale must be considered.

- The changes being introduced through this project could have negative impacts on IGTs undermining efforts to extend the network. This could have a negative impact on fuel poverty.

- Ofgem has not followed due process in progressing this project. For example, commitments made by the Authority in previous document regarding how the changes to the exit regime would be progressed have been disregarded to be replaced with an approach without normal industry governance. Other issues raised in writing with Ofgem have not been addressed.

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[1] We note that the “detailed explanation” of the proposals relating to offtake flexibility in one of the appendices has been published months after Ofgem requested cost information.

- In keeping with this, the process adopted is not consistent with the Authority's Gas Act obligations in respect to the principles of best regulatory practice. These issues have been raised formally and not addressed; the Authority should set out how these principles have been, and are being, met in its final decision.

- We remain disappointed that no member of the Authority has been willing to meet with industry participants to discuss issues and concerns throughout this process; this is not consistent with a transparent and accountable process.

- Ofgem's view that there is a high potential for discrimination appears to a recently developed justification to change the exit regime; given that previous reasons for changes could not be sustained. We continue to advocate that changes are only proposed once problems have been clearly identified and understood.

- There remains a need for a detailed implementation plan to be developed between NGT and Ofgem which fully sets out the dependencies, timescales etc. While it may be that this is NGT's project, it remains Ofgem's responsibility to ensure that the best result is achieved in the interests of consumers which must include minimising risk and costs associated with a poor implementation. Ofgem also has a responsibility to ensure that NGT is not able to use its position in such a way that has negative impacts on the competitive market participants.

- The plethora of documents, consultations, papers, workgroups etc, makes it extremely difficult to keep up with this project despite extra resource put on it. This in part reflects the fact that the project was not properly scoped initially and that extra areas were added later. This approach is not indicative of an transparent process but instead undermines the ability of market participants to understand and effectively respond to the complex changes being proposed; the quality of the consultations being undertaken has been compromised.

- We reiterate Shell Gas Direct's position is that we have no objection to the sale of one or more NGT's gas distribution networks. We consider this to be a commercial decision by NGT. However, given the extent of unresolved issues, risks to this project and potential for costs to outweigh the benefits, at this time we consider the status quo, "no sale" option to be in the best interests of consumers.

Yours sincerely

Tanya Morrison
Regulatory Affairs Manager

National Grid Transco – Potential sale of gas distribution network businesses Final Impact Assessment November 2004

Response by Shell Gas Direct

I refer to the document above and its appendices. These documents outlines the proposed structure of the gas industry should the sale of one or more of National Grid Transco's gas distribution networks (DNs) go ahead. Shell Gas Direct (SGD) is a shipper and supplier to non-domestic consumers. As we have stated in previous responses to consultations by Ofgem on this subject, we have no objection to the sale of one or more the DNs by NGT. We consider this to be a commercial transaction. However, we consider it essential that the sale and the structure adopted for a post-sale environment is not to the detriment of consumers. On the basis of the material presented in these documents and elsewhere, we consider that there is a risk for the costs will be higher than set out in Ofgem's documents.

Potential benefits

We understand that 95% of the benefits Ofgem describes arise from comparative regulation. There are a number of issues with the approach taken by Ofgem. As has been raised with Ofgem previously, the benefit calculation here appears to double count what has already been claimed as a benefit from separate DN price controls. At the time that separate controls were introduced, significant benefits were claimed although no analysis was produced so it is difficult to make a direct comparison. It appears to us that the marginal benefit of having separate ownership (as opposed to separate controls) is somewhat less than Ofgem's calculations. We consider there to be a significant risk that the benefits calculated from the sale alone will be lower than estimated by Ofgem and consider that Ofgem's "low case" should be considered the "base case".

There may also be disbenefits through the loss of economies of scale through the break up of what is essentially a single gas transporter. We are not clear that this has been considered by Ofgem.

We note that NGT has agreed a customer "safety net" to protect customers' interests if only the sale of only one DN went ahead (with Ofgem's expectation that this could result in a negative net benefit). We are not certain that the safety net agreed is sufficient to cover the full negative effect of such an outcome.

We are also aware of concerns raised by some Independent Gas Transporters (IGTs) that the indirect effects of the DN Sale could lead to projects to extend the gas networks being negatively affected. We have understood network extension to be a key factor in the Government's fuel poverty strategy and consider that this must be explored and understood further to ensure that the sale does not negatively affect this group of consumers.

Potential costs

Throughout this document, Ofgem has made various assertions that the sale of the DNs "may" or "could" have positive benefits (106 and 86 times respectively). It must be assumed that in every case, they may not or could not have these effects. It seems reasonable, therefore, to conclude that the "mays" and "may nots" are equally distributed and the overall effect with be neutral.

Our most significant concerns with the IA assessment are in respect of costs which have not been factored in by Ofgem. Ofgem's approach to costings appears to be focused on minimising these through discounting or reducing costing submitted to it. In other cases, Ofgem appears not to have taken into account or fully understood the implications (and costs) which will result from the sale. We outline some of the main issues below. We do not consider this to be a full list of areas which lead us to consider that Ofgem has significantly under-estimated the cost implications of the potential DN sale.

Metering

We cannot find in this document any evidence that Ofgem has factored in all the costs which arise directly from the potential sale, notably in relation to meters and file flows. The impact at hive down is underestimated and the future costs appear not to be included. Our comments are based on our understanding from recent meetings on the impact of DN Sales on Metering Arrangements hosted by Transco Metering Services (TMS), including the one held earlier this week on 14th December 2004. It cannot, and should not, be assumed by Ofgem that the fact that there is metering competition resolves this issue.

We understand thath TMS will now be refining the transitional arrangements so expect to have a clearer picture of the impact on our business in January 2005. We expect the greatest costs to suppliers not to be at "hive down" but to in 12 months the IDNs take over responsibility for their part of metering arrangements. We understand that the January workshops will aim to better quantify the impact of the network sale on suppliers and to refine the transitional arrangements. Until this is done, it is difficult to estimate the cost for suppliers but we consider that this could be the most significant cost to us. We have not presented any information about costs for metering in our pro forma as in September TMS had yet to make clear the full implications.

There is a high risk of on-going costs and deterioration to data associated with this. TMS have stated that it "hoped" that IDNS will adopt the RGMA baseline. However, at least one potential DN purchases has suggested that whether it does chose this will be dependent on "commercial needs" may result in deviations from baseline. The risk is that the industry will end up with a situation where multiple gas suppliers are interacting with multiple networks using multiple systems that may or may not be adhering to the RGMA baseline. We must emphasise that this is not an issue for the agency which will cover shipper to transporter file flows. RGMA file flows are focused on the "supplier hub" principle.

There are numerous specific issues on file flows, contractual issues, invoicing (RGMA invoicing group to be reformed in January); system implications; timescales, increased on-going staffing needs in the future etc which have not yet been included in cost estimates.

TMS is not investing enough to ensure that these problems are resolved. For example, when a file is sent giving market participant, this will indicate TMS. Instead, we will expect to receive 2 files but when sending on to the GTs (via the agency), it is likely that the second will be rejected. This means that the GT will not know who the meter owner is. There is a high risk that this, and related problems, will result in significant deterioration in data quality with associated impacts on customer billing and transfers. This undermines any potential benefits that could arise out of the current customer transfer project (CTP). Shell Gas Direct is proud of its record on customer service. One service we provide is providing responses to customer queries. At present, we have no idea how the different query management systems will be managed. The new DNs will need to build new systems. While they may be to the same specification, it is likely that they will differ, again leading to data quality issues. We know from experience with Gemini that building a like-for-like system based on a specification does not necessary provide this result.

Customer transfers and supply competition

We recognise that the agency concept has been developed to minimise the negative impact of the sale on supply point administration (SPA) and other central systems. However, Ofgem appears to assume that this means that there will be no negative impact on competition. The added complexity of multiple DNs (including having to sign multiple network codes), data complexity (including metering impact above) and other issues could create a barrier to entry. Anything which creates a deterioration in data quality will have a negative impact on customer transfers, and therefore on competition itself. We are also concerned that exit and flexibility products could negatively impact transfers of NTS direct connect customers. We discuss this further below.

Risks & Processes

SGD has raised with Ofgem a number of concerns regarding the processes adopted by both Ofgem and NGT in taking this project forward. We had expected the Development and Implementation Steering Group (DISG) to actually steer the project going forward. However, Ofgem decided to change the remit of this group and it appears to have been a discussion group. The fact that the meetings have been open has not meant it has made a satisfactory replacement for proper consultation nor has it allowed for a useful way of keeping up with the progress of the project. DISG minutes are not agreed by all participants and has no decision making powers. NGT has on many occasions referred to “decisions made at DISG” when they appear to mean decisions made by Transco and Ofgem with minimal industry input.

We continue to consider that much more detail is required to ensure that this project can be efficiently implemented. Published plans are very high level and need much more detail on interdependencies to allow us to be able to plan the way forward. There continues to be a lack of detail on changes to computer systems and to the post-sale arrangements. We have some information on when “hive down” will occur but remain unclear as to the process that Ofgem will adopt to approve the purchasers.

We consider that the Unified Network Code (UNC) developments had occurred under the auspices of the Network Code Panel. In effect, the introduction of the UNC is a modification to the existing Network Code arrangements. We would welcome Ofgem’s views on the process for the Authority to designate the new Code arrangements. There has been no industry agreement on future governance arrangements for the UNC and there is no document of how Ofgem understands NGTs proposals will work. Shell Gas Direct has participated in a process led by the Gas Forum to review and making proposals to improve the governance of the Network Code in light of experience of its workings. We would expect such changes to be carried forward into the UNC.

Offtake and interruption arrangements

We have yet to see any clear evidence from Ofgem that there is a high potential for undue discrimination by Transco under the new arrangements. Discrimination is be used to justify the introduction of the exit and offtake arrangements. We noted that there the comparable situation in electricity is being addressed through licence conditions and would like Ofgem to address this point. We understand that no shipper nor potential DN owner considers that discrimination to be a significant issue. Furthermore, we cannot understand why if Ofgem considers this to be important, it has chosen not to have legal separation between Transco's DNs and the NTS. The reasons provided are not robust: we cannot understand why there would be any risk of a fragmented NBP with legal separation. If there is, the risk is the same for the sale of DNs overall.

We had expected from the Authority's decision on exit and interruptions, that the changes proposed by Ofgem would be taken forward through normal code governance as set out in the document. This has changed since the document was published and we would welcome an understand of the reasoning behind this. We also note that how Ofgem described the new arrangements in its note for the shipper pro formas also differed from the Authority's earlier decision.

The proposed changes will impact NTS direct connect consumers (eg industrial loads). This will not be an indirect effect but a direct effect. To the best of our knowledge, these consumers have not been asked to provide any costings in respect of the change. We cannot understand why Ofgem did not seek a derogation to the Gas Act to allow for these customers to contract direct with Transco NTS. This has been discussed for many years and could have been taken forward with the other DTI exemption.

It remains the case that shippers have no information on these consumers' future demands for firm capacity. As many of these consumers are supplied on one or two year contracts, we do not know which of the NTS consumers we will be supplying 3 or more years hence. Consumers who wish to remain firm are not being provided a choice but being obliged to bid ahead (through their shipper) to ensure that they can continue to have their current firm rights maintained at LRMC. We do not consider that most of these consumers have understood the implications and consider it imperative for Ofgem to ensure that they communicate the changes to this directly affected group of consumers. It must be noted that consumers will need to make decisions about the trade offs of buying exit capacity many years ahead versus the risk of shorter term products. Shippers will not be able to do this on consumers' behalf as this could be seen as providing financial advice under the FSMA. All shippers will be able to do is submit the bids onto systems. Shippers will also need to make changes to contracts to allow this system to work which will make transfers more difficult.

It is not yet clear how this will work at shared supply meter points. Shared supply meter points were introduced for the benefit of customers to resolve problems that they had with interruptions in the early years of the Network Code. It would be unfortunate if this solution, which has worked well, was to be undermined.

If Ofgem considers its proposals to be in the interests of consumers, it should feel confident about allowing them to be debated separately from the DN Sale process and subject to an impact assessment based on the actual final framework. This must include requesting cost data from directly affected consumers.

Other issues

We are aware that there are numerous outstanding issues to be resolved. Issues logs for UNC, exit, SPAAWG etc all have significant areas which are incomplete. This increases the risks associated with project implementation as it is likely that there will be numerous work arounds, problems etc which could be avoided with more robust project planning and concentration on those issues which are necessary to be resolved for this project to go forward.

If you would like to discuss any of the above, please feel free to contact me on the above telephone number.

Yours sincerely

Tanya Morrison
Regulatory Affairs Manager