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Dear Tim

**UNC Modification Proposal 0229 – Mechanism for correct apportionment of unidentified gas**

Shell Gas Direct (SGD) Ltd, the holder of both gas supplier (non-domestic) and shipper licences, offers the following comments in response to this proposal. Please note, this response is not confidential and so may be placed on your website.

SGD raised UNC Modification Proposal 229 in response to a number of other related proposals, ie. 194 and 194a, that each sought to address the potential need to allocate volumes of unallocated gas to from the Small Supply Point sector to the Large Supply Point sector. Whilst in the developmental workgroup, two other related code proposals, 228 and 228a, went out for consultation.

For the avoidance of doubt, SGD is strongly in favour of implementation of UNC Code Modification 229 ('229').

**Background**

SGD's rationale behind 229 was and remains a mirror image of its concerns with these other code proposals (and we would refer Ofgem to our comments in previous responses). In short, however, SGD's concerns with the other proposals were:

- an opaque methodology behind the calculation of gas volumes to be allocated, with the impact potentially being the misallocation of costs that would distort competition;
- the use of the RbD mechanism that would almost certainly increase the tendency towards market concentration in the retail markets, ironically at the same time as Ofgem was looking at these markets as part of its Energy Probe;
- year-on-year uncertainty as shippers sought to raise code proposals to change the way volumes should be apportioned in their favour – somewhat different to seeking an equitable and impartial approach to the correct and non-distortionary allocation of volumes; and
- Ofgem would, in effect, be asked on an annual basis to approve volume apportionment (through its decisions on code proposals).

**UNC Modification Proposal 229**

229 seeks to address the issue of the apportionment of unallocated gas by appointing an independent and impartial third party expert to calculate how the volumes of gas should be apportioned. While this proposal seems to have widespread support from all categories of parties, large and small, who have entered the market since liberalisation, other parties have been less supportive of such an approach.

It is difficult to understand why any shipper should be concerned with 229 given what the proposal says regarding:

- the central role for shippers and UNCC in appointing such an expert;
- the need for the expert to adhere to the set of high-level allocation methodology principles;
- the annual approval of the AUGS and the right to suggest proposed changes; and
- the ability to veto any work of expert that produces clearly erroneous results

All shippers, including those who may have proposed earlier modification proposals, should be content with 229 if their concerns were that they felt disadvantaged by the current arrangements. This situation will be rectified by 229; the extent to which shippers are financially recompensed will obviously depend on the conclusion of the independent expert. The fact that 229 proposes not to use the RbD mechanism (see our response to 194 and 194a for our views on this point) should be immaterial.

With regards to the GTs, SGD is unconvinced of the reality of transporters' concerns regarding 229's proposition that they contract with the independent expert on behalf of shippers. These concerns have ranged from questions of legality to a more simple: Why us?

Firstly, throughout the development of 229, some GTs consistently laboured the point that they had concerns with the legality of the suggested approach, although no details were ever provided. However, these concerns seemed to be contradicted by comments from their own lawyer<sup>1</sup>. To the extent that these concerns are raised again, this apparent difference of opinion needs to be addressed.

Secondly, some GTs have queried why they should be involved and, to the extent that they are, why they can't have an expert of their own choosing, ie. xoserve? SGD would counter with the following comments:

- An alternative model would see shippers contracting with the expert but the considerable difficulties in constructing a multi-party contract rule this out as practical option.
- One of the drivers for proposing an independent third party expert is to remove any element of concern with respect to vested interests and/or impartiality. To the extent that transporters wish to nominate xoserve, then there is nothing to stop them from doing so and it will be up to UNCC to decide whether or not they qualify as independent and impartial.
- Given that shippers are meeting all the costs and providing GTs with comprehensive financial and legal indemnities – even to the extent that we suggested GTs should word this part of the proposal in a manner of their choosing - it is not clear why shippers are not able to benefit from the contestable market that exists for the type of work to be carried out by the expert?

In any event, a large dose of reality is required. What actually does 229 ask of transporters? Essentially, nothing more than agreeing to act as a contracting party on behalf of **their** customers, ie. shippers, to give effect to a mechanism that will help preserve competition in the retail markets. If, however, the suggested role is beyond the GTs, then perhaps they should explain why, at a time of regulatory and customer concern with market concentration, as monopoly transporters they are unwilling to help resolve an important issue? If the GTs had a financial interest or exposure in the matter, then their reluctance would be easier to understand. However, this is not the case.

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<sup>1</sup> See the minutes of the Distribution Workstream, 14 May 2009

## **Other comments and Conclusions**

Clearly, some parties will send in critical comments. To that degree we would ask Ofgem to:

- ensure that in considering its decision, it clearly identifies comments that show this proposal is unworkable whilst incorporating its basic principles, as opposed to the fact that it needs adjusting or amending in certain respects. For instance, to the extent that the tendering process needs to be amended, this can be done but that does not invalidate the use of an independent expert per se; and
- take a realistic view of how much more work was needed to be done before this proposal was allowed to see *even* the light of day?

As the proposer, SGD is clearly in favour of implementation as we believe 229 will better facilitate the relevant objectives, in particular:

***Standard Special Condition A11.1(b): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.***

The issue of the apportionment of unallocated gas has gone on for far too long. 229 has been developed to some degree of detail and SGD would like to place on record its thanks to all who have proactively contributed in this regard.

I trust that you find our comments helpful. Please do not hesitate to contact me should you have any questions or require further clarification.

Yours sincerely,



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**Shell Energy Europe BV**