

# Arthur Probert

**Business Consultant**

6 Glebe Field Garth  
Wetherby  
West Yorkshire  
LS22 6WH

Tel: 44 (0) 1937 520107  
Mob: 44 (0) 7814 009762

E-mail: arthur.probert@ntlworld.com

Kyran Hanks  
Director, Gas Trading Arrangements  
Office of Gas & Electricity Markets  
9 Millbank  
London  
SW1P 3GE

**BY E-MAIL**

E-mail: kyran.hanks@ofgem.gov.uk

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Dear Kyran

## **National Grid Transco – Potential Sale of Network Distribution Businesses**

Thank you for the opportunity to comment on the issues raised in this document. I am responding on behalf of Contract Natural Gas Limited (CNG), who are retaining me to deal with this matter for them.

CNG is one of the smaller Industrial and Commercial shippers and suppliers in the industry. They also successfully ship gas for a number of suppliers and are closely associated with a new entrant to the market, Global Natural Gas Limited.

NGT's proposals will bring fundamental changes to the gas supply industry. The sale has the potential to make the operation of the industry much more complex and so increase the barriers to entering and developing in the industry. The issues raised, therefore, need careful consideration. We would suggest that Ofgem will need to be confident that the following issues can be resolved positively before giving its approval to undertaking the programme of work needed for NGT to dispose of one or more distribution network businesses.

### **The Likelihood of Minimal Change in Practice**

Major change programmes have a disproportionate effect on the smaller players in an industry. Consequently, we applaud the stated intention of achieving the changes with minimal disruption to shippers. However, we are sceptical about how realistic this ideal is.

The consultation paper implicitly assumes that separated distribution networks (DNs) will be operated with the same objectives as an integrated transmission and distribution network, even though the technical characteristics of a standalone distribution network will be very different. Each of the DNs has different asset mixes and constraints, so safety and security of supply considerations are likely to lead to different network owners having different objectives.

The paper also recognises the potential for the NTS to discriminate at the expense of independent distribution networks and is expecting a new management to drive in cost savings. These factors suggest that all major gas transporters are likely to develop different objectives, operating procedures and commercial targets from those that Transco has applied.

The assumption, therefore, that future network owners will retain the existing objectives, which underpins the case for minimal disruption, should not be relied upon. Instead, the claim of minimal disruption is likely to be difficult to achieve and the regulatory impact assessment should assign a low probability to it.

#### Defining and Applying the NTS / DN boundary

Understanding how gas flows across the boundary between the NTS and the distribution networks will be managed will be critical. Ofgem's work so far on the NTS exit regime has shown that this boundary is not straightforward and that actions in one area will cascade onto other parts of the system. Resolving this issue will require more than just attributing responsibilities to the NTS or DNs, but will need a comprehensive definition of the boundary, along with effective and pragmatic business rules that do not give shippers incompatible obligations across the various parts of the system.

NGT's model of passive DNs reliant on the NTS is not the only way to look at the boundary. The interruptions this summer showed that at certain times the NTS was dependent on using DN linepack to maintain its operating regime. Transco presentations<sup>1</sup> have also described how they prefer to keep the NTS as close as possible to steady state, so that diurnal flows are as much of a benefit to the NTS as they claim is the case for the DNs.

NGT's retention of some distribution networks means that securing non-discrimination across DNs will be important. The regulatory regime will need to ensure that security of supply is equivalent across the country and that the rules for interrupting supplies on distribution networks are clear. The regime will also need to ensure that there are common standards of performance and that each network operator bears a fair share of common costs; e.g. for the billing and SPA agency.

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<sup>1</sup> E.g. to Review Group 513

## The Robustness of the Regulatory Impact Assessment (RIA)

The development of an RIA is welcomed. The assessment needs to be rigorous as it will be a key input to the Authority's decision on whether NGT's proposals are worth pursuing. In particular, we believe it needs to be clear that benefits from other programmes, such as the NGC / Transco merger or exit reforms, are excluded to avoid double counting.

Any deterioration in safety standards can not be contemplated. However, to demonstrate in advance that a disaggregated network will perform as effectively as an integrated system, it is likely that additional obligations will be placed on all parties in the system. The HSE's consultation on principles for assessing safety cases will give some insight into how much extra the industry will be asked to do to compensate for network separation. The RIA, therefore, should also recognize that there are likely to be extra ongoing costs arising from the safety arrangements for a more fragmented industry.

Our current understanding is that the RIA only uses benefits anticipated from the operational expenditure improvements that should follow separation. We are, therefore, unconvinced that the current version of the RIA supports a case for rolling in exit and SPA reforms to the programme and its ambitious timetable. If other reforms are to be included in the separation programme, the RIA should show the net benefit from this course of action, after taking into account the extra costs from the greater complexity of multiple change and testing programmes.

We also note that a linepack regime is required between the NTS and the DNs and that this could be widened to encompass shippers. Again, any proposal to introduce such a scheme for shippers alongside the separation programme should be backed by its own RIA that identifies the benefits of bundling these changes into the programme.

We understand that the RIA is at a high level and will be developed further. Given the importance of the RIA in informing the Authority's decision, we would welcome the chance to comment further on future versions.

## The Minimal Impact Approach

Despite our concerns on the ability to deliver it, we strongly support actions which can minimise the impact on shippers from the sale of a distribution network. Maintaining a single balancing point, with balancing obligations over the network as a whole, and the establishment of an agent to provide common billing and SPA interfaces are critical components of this approach. Compromising on any of these points will dramatically increase the costs from separation. The difficulties experienced with IGTs show the importance of a common interface, particularly for the change of supplier process.

Developing a uniform network code seems a pragmatic approach in the first instance; however this could become unwieldy over time, as it is required to accommodate the differing objectives that are likely across different networks.

## Consequential Changes

NGT's desire to complete the sale of at least one distribution network by October next year is ambitious, particularly as the scope of the changes necessary is not yet defined and the process for defining the scope is likely to iterate between policy and legal issues. This timescale also assumes that minimal change will be achievable. When setting milestones, time will need to be allowed for shippers and suppliers to make the consequential changes in systems and procedures, so that shippers are not unduly disrupted or burdened with greater risks from the changes, which are driven solely by their monopoly supplier's commercial interests

## Within Day Gas Balancing

Transco's ability to manage within day variations in NTS linepack should not be intrinsically reduced by the sale of a distribution network, provided the NTS / distribution network boundary is properly defined and appropriate commercial, information and operational arrangements are in place between Transco and the distribution network owner. It would seem, therefore, to be in NGT's interests to get these relationships right, rather than relying on changes to other parts of the regulatory regime, such as shorter balancing periods, to cover any failings.

We agree that high quality information should help address any potential management difficulties Transco might face. However, care will be needed when interpreting the data that comes from the distribution networks. In particular, it is essential that any claims of deterioration are based on comparable data. Individual distribution networks will experience more variation than the aggregated network, as increases in some areas will be offset by decreases in others. Any calls for further changes to the balancing regime will need to be supported by like-for-like comparisons.

## The Treatment of IGTs

Supplier and shippers already experience significant operational differences across IGTs. This could be compounded if different distribution networks apply different approaches to their IGT interfaces. We would urge Ofgem to investigate how IGTs can be brought into the regime under discussion here.

I hope you find these comments useful. Please call me if you wish to discuss them any further.

Yours sincerely

**Arthur Probert**

c.c. Colin Gaines                      Chief Executive, Contract Natural Gas Ltd