

**National Grid Transco – Potential sale of  
network distribution businesses**

**Agency and governance arrangements**

**Regulatory Impact Assessment**

April 2004

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# 1. Introduction

## ***Purpose of this document***

- 1.1. The purpose of this document is to consult upon Ofgem's regulatory impact assessment (RIA) on the various options for the development of appropriate agency and governance arrangements in the context of Transco's proposal to sell one or more of its distribution network (DN) businesses.
- 1.2. This RIA is intended to contribute to the development of an operational, commercial and regulatory framework that could support a divested industry structure. Following the completion of the consultation process, the framework that is developed will form the basis of an alternative to the present Transco owned and operated transmission and distribution arrangements. The conclusions of the RIA will be included in Ofgem's broader RIA on whether the Gas and Electricity Markets Authority (the Authority) should consent to Transco's proposed disposal of DNs.

## ***Background***

- 1.3. In May 2003, Transco publicly announced that it would consider the sale of one or more of its DNs if it were to maximise shareholder value. Any such sale would require the consent of the Authority, the Health and Safety Executive and the Secretary of State for Trade and Industry.
- 1.4. In July 2003, Ofgem issued a consultation document on the regulatory, commercial and operational changes required to facilitate the sale of one or more DNs.<sup>1</sup>
- 1.5. Following this consultation, in December 2003 Ofgem issued its Next Steps document setting out responses to the July consultation, Ofgem's current views and a proposed way forward for considering Transco's proposals including the

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<sup>1</sup> *National Grid Transco – Potential sale of network distribution businesses, A Consultation Document.* Ofgem, July 2003.

establishment of workgroups to take forward the development of a commercial and regulatory framework.<sup>2</sup>

### **Workgroup processes**

- 1.6. Since the release of the December document, Ofgem has established several workgroups including a Development and Implementation Steering Group (DISG), a Commercial Interfaces Workgroup (CIWG), a Regulatory Architecture Workgroup (RAWG) and an Agency Workgroup to continue the proposed DN sales consultation process.
- 1.7. The workgroups have met regularly since January. The workgroups have been successful in providing industry participants with an opportunity to contribute to the development of a possible commercial and regulatory framework that would enable the implementation of Transco's proposals, should Transco obtain the necessary consents. They have focussed upon two key issues:
  - ◆ the allocation of roles and responsibilities between Transco, as owner of the NTS, and each of the DNs (both retained and independent); and
  - ◆ the development of appropriate agency and governance arrangements for shipper (and consumer) interfaces, particularly focusing on supply point administration frameworks.
- 1.8. The discussions that have occurred through the workgroup process have highlighted the importance of these issues to the development of the commercial and regulatory framework.
- 1.9. In light of these discussions, in March 2004, Ofgem issued a "way forward" document indicating that it would be appropriate to develop for consultation separate RIAs on these two issues<sup>3</sup>. Ofgem considered that the release of these RIAs would be consistent with the Authority's duty to carry out impact assessments<sup>4</sup>. Since the release of Ofgem's way forward document, the workgroups have undertaken further work on agency and governance issues so as to inform the development of this RIA.

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<sup>2</sup> *National Grid Transco – Potential sale of network distribution businesses, Next Steps Ofgem, December 2003.*

<sup>3</sup> *Potential sale of gas distribution networks, Ofgem update on way forward, Ofgem, March 2004*

<sup>4</sup> This duty is contained in section 5A the Utilities Act 2000.

- 1.10. Ofgem indicated that it would issue its consultation on these RIAs in the event that the Authority takes the decision at its April meeting that it is appropriate for work to continue on DN sales proposals.
- 1.11. At its April meeting the Authority did decide that it was appropriate for further work to continue on Transco's proposals. As such, this RIA is now being issued.
- 1.12. Ofgem hopes to reach a decision on Agency and governance arrangements by the end of May 2004, although this will depend on whether any new and material information is received from respondents which results in Ofgem having to carry out further analysis.
- 1.13. The document is structured as follows:
- ◆ Chapter 2 sets out the background to this RIA;
  - ◆ Chapter 3 sets out Ofgem's objectives with respect to DN sales and this RIA on governance and agency arrangements;
  - ◆ Chapter 4 describes the key issues that arise in the development of appropriate governance and agency arrangements for shipper (and consumer) interfaces;
  - ◆ Chapter 5 describes the different options that have been put forward;
  - ◆ Chapter 6 considers the broader industry impacts of the proposals, in particular the potential impacts on competition and the environment;
  - ◆ Chapter 7 evaluates the potential costs and benefits associated with the various options; and
  - ◆ Chapter 8 sets out Ofgem's initial views.

### ***Views invited***

- 1.14. Ofgem welcomes views on this RIA, to be received by close of business 17 May 2004. Respondents are requested to provide views in a timely manner. Responses should be addressed to:

Sonia Brown

Director, Transportation

Office of Gas and Electricity Markets

9 Millbank

London SW1P 3GE

(Telephone: 020 7901 7412)

- 1.15. Electronic responses may be sent to [tracey.hunt@ofgem.gov.uk](mailto:tracey.hunt@ofgem.gov.uk)
- 1.16. Respondents are free to mark their reply as confidential, although we would prefer, as far as possible, open responses that can be placed in the Ofgem library. Ofgem would also prefer that non-confidential responses are sent electronically so that they can be placed on the Ofgem website.
- 1.17. If you wish to discuss any aspect of this paper, Mark Feather (telephone 020 7901 7437) or Jessica Hunt (telephone 020 7901 7431) would be pleased to help.

## 2. Background

- 2.1. This Chapter introduces the concept of a central service provider (the agency) which could discharge many of the functions and services that are currently provided by Transco following a potential sale of DNs. The chapter also sets the services that Transco currently performs and provides and which could potentially be provided in the future by an agency in order to support both wholesale and retail gas markets. It also provides an overview of the IT systems that support these functions.

### ***Impacts of a potential DN sale***

- 2.2. The potential sale of one or more gas distribution networks has significant implications for the systems and process interfaces that presently exist between shippers, suppliers and Transco. In this respect, the sale of DNs could require changes to data management, supply point administration (SPA) and system operation information interfaces as shippers and suppliers may need to develop different processes and systems to deal with different DNs. The creation of fragmented processes and systems has the potential to impose significant costs on shippers and suppliers, and may also create barriers to entry to wholesale and retail markets. These costs would ultimately flow through to customers.
- 2.3. Transco's proposals to retain ownership of one or more DNs following a potential sale will also create the potential for it to discriminate in favour of those DNs that it continues to own, over those that it has sold. This also has the potential to distort wholesale and retail markets, increase operational costs for DNs and may, ultimately, impose costs on customers.
- 2.4. Conversely, the impact of comparative regulation following the sale of one or more DNs may also produce innovation and improvements in the delivery of many of the services currently provided by Transco. These benefits would ultimately flow through to customers in terms of reductions in allowed DN revenue set through the price control process.



## ***The creation of the agency concept***

- 2.5. In view of the potential cost impacts associated with separating the ownership of DNs, the concept of an agency has been introduced as an entity that could provide many of the services currently provided by Transco on a centralised basis. The purpose of creating this entity would be to minimise and mitigate the costs associated with moving to a more fragmented industry structure. For example, the Agent could take on the management of supply point administration (SPA) processes rather than each different network owner undertaking this activity separately.
- 2.6. In establishing this entity, careful consideration needs to be given to the nature and range of services that it should provide. Ultimately, the scope of these services will be determined by the extent to which the costs that are mitigated by centralising certain services through the proposed agency outweigh any potential benefits associated with having each DN owner provide these services as a separate entity. It should be noted in this context that having an agent to provide certain functions and services will, in itself, have cost implications. It will prevent customers obtaining any of the benefits that would have otherwise accrued through DNs providing these services on a potentially more efficient or innovative basis. However, it should be noted that the introduction of incentive arrangements on the Agent could still encourage innovation in provision of these services.
- 2.7. In April 2004, Transco announced that it has established a separate internal business, to be known as xoserve, that will undertake many of the activities discussed in this document, although, of course, the precise scope is still to be determined. Further details are provided in Appendix 3. A key point to note is that this business will provide services to Transco irrespective of whether a sale of one or more DNs proceeds.
- 2.8. In this Chapter, Ofgem has set out what it considers to be the full range of services and functions currently provided by Transco and which could ultimately be provided by the agency. A further discussion of the options for allocating these services is included in Chapter 4.

- 2.9. It is important to note that in assessing the scope of the agency we have considered the present arrangements that apply in the electricity sector. In this sector, National Grid Company (NGC) discharges many of its obligations to provide settlement and balancing services through its wholly owned subsidiary company, BSC co (known as ELEXON). For example, ELEXON administers changes to the Balancing and Settlement Code (BSC) and manages the settlement process in the wholesale and retail electricity sectors.
- 2.10. However, it should be noted that there are also important differences between the gas and electricity sector. For example, ELEXON's role is restricted to providing settlement and balancing services at a transmission level whilst each electricity distribution network owner takes on separate responsibility for managing settlement at a local level. These differences are largely attributable to the historical structure of the electricity sector, where electricity distribution businesses have been separately owned since privatisation.

### ***Potential range of activities for agency***

- 2.11. In this Section we describe the activities that may or may not be included in the centralised agency role. As described previously, all of these activities are currently undertaken by Transco.
- 2.12. Figure 1 sets out the range of activities that are currently undertaken that could be incorporated within the agency. Figure 2 details the IT systems and processes that support Transco in undertaking these tasks.

Figure 1: Range of activities that could be undertaken by agency

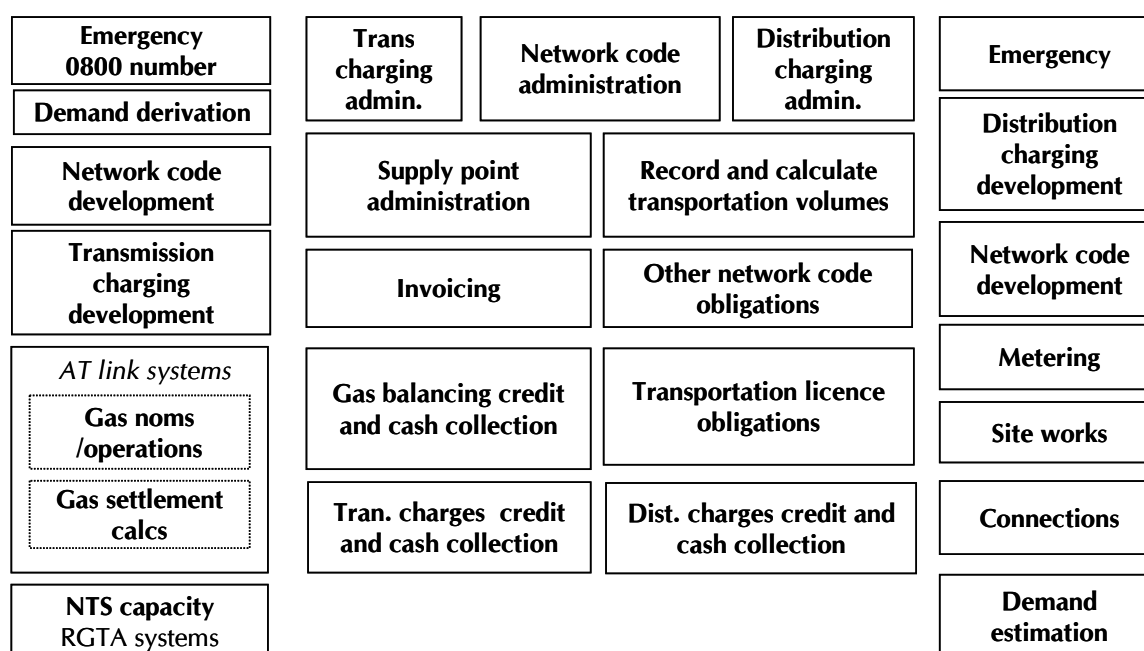
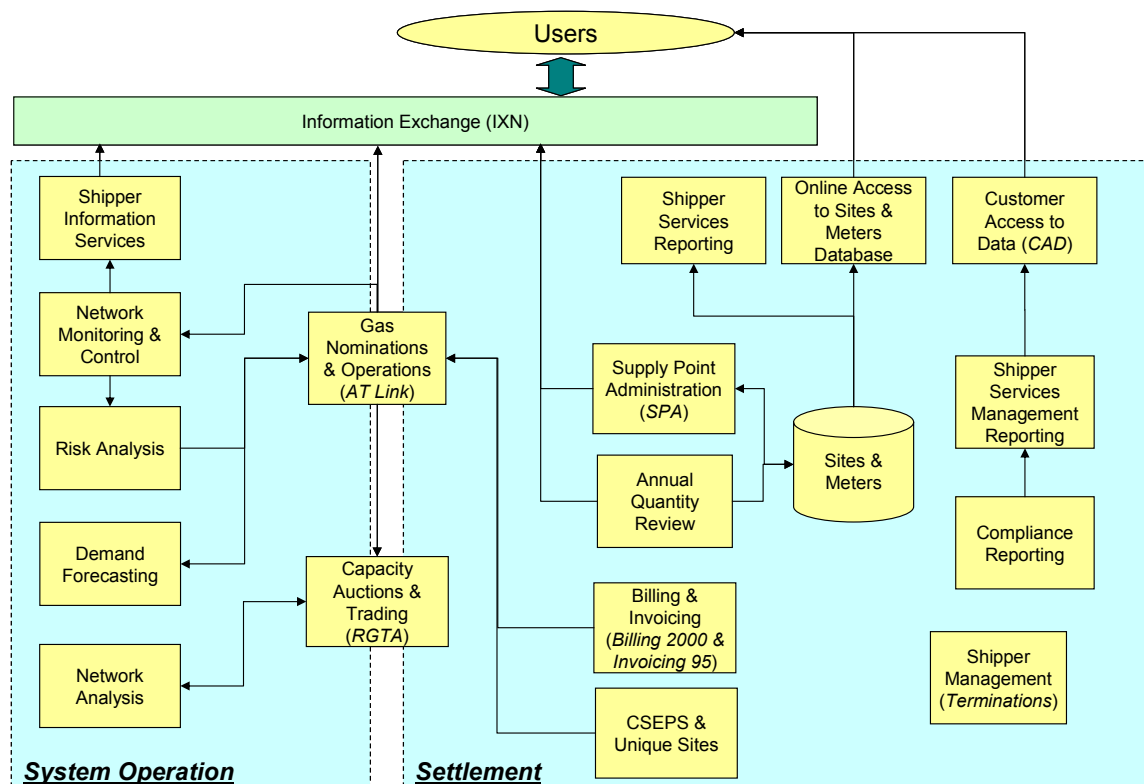


Figure 2: IT systems and processes supporting Transco's delivery of activities



2.13. In the following subsections, we set out:

- ◆ the scope of each activity as detailed in Figure 1 and the core processes that underlie them; and

- ◆ the systems that support the activity.

### **Supply point administration (SPA)**

2.14. Under the Network Code, Transco is obliged:

- ◆ to hold and maintain a register of all supply points, supply meter points, and supply point premises connected to a network operator's pipeline system. To facilitate retail competition, and therefore to protect customers, the register must be updated to allow the transfer of supply points between suppliers;
- ◆ to provide query management services in relation to shippers' queries regarding supply points; and
- ◆ to record and log data as required under the Network Code. This includes data associated with firm load shedding contact details required for large offtake sites.

2.15. The systems supporting this activity are principally:

- ◆ the Sites & Meters database (S&M database);
- ◆ the Supply Point Administration (SPA) application;
- ◆ ConQuest, a query handling system; and
- ◆ Unique Sites.

### **Record and calculate transportation volumes**

2.16. The activity involves calculating and recording gas volumes flowing through the network to ensure that valid and reconciled metered data is recorded. This activity has two key features:

- ◆ the determination and amendment of the Annual Quantity (AQ) for the gas year and the Supply Offtake Quantity (SOQ) (a measure of peak offtake) for each supply point; and
- ◆ validation of meter readings and subsequent calculation of metered quantities for supply points.

- 2.17. These quantities are used to calculate each supply point's transportation charges. This activity is supported by the S&M database, the SPA application, the Unique Sites and CSEP databases and the AQ Review and demand forecasting applications.

### **Invoicing**

- 2.18. The invoicing activity enables the production of invoices to shippers. This relates to two sets of charges:
- ◆ **charges for use of the network.** This includes charges on the NTS, LDZs and associated reconciliation charges; and
  - ◆ **energy balancing charges.** The settlement process seeks to calculate each shipper's imbalance position defined by inputs, offtakes and net NBP trades for each gas day. The extent of each shipper's imbalance determines the cash out payments or revenues for each shipper on each gas day. In cases where the shipper is in deficit it pays a cash out charge and in cases where it is in surplus, it receives a cash out payment. Hence, the transportation invoices include an item (which may represent a payment or a charge) for each shipper in relation to their energy balancing performance.
- 2.19. Invoicing 95 supports this activity based on the validated physical data and contractual parameters. Billing 2000 supports billing data management and ad hoc billing services. Query services to Shippers are provided by the ConQuest system.

### **Energy balancing credit management and cash collection**

- 2.20. The energy balancing regime requires the collection from and disbursement to shippers of energy balancing charges and revenues. Given that the energy balancing regime will often place shippers under an obligation to pay for deficits incurred in the day, known as cash out, the regime has a set of codified credit arrangements that protect the settlement arrangements and therefore customers in the case of default by any shipper. Hence, this activity includes:

- ◆ implementing decisions of the relevant Energy Balancing Credit Committee;
  - ◆ maintaining a record of a shipper's Secured Credit Limit;
  - ◆ the calculation of a shipper's outstanding relevant balancing indebtedness (to assess the level of debt that a shipper owes to settlement in a given time period);
  - ◆ the submission of cash calls; and
  - ◆ taking of enforcement and recovery steps in the event of the non payment of energy balancing charges by a shipper.
- 2.21. The above activities are supported by offline consolidation of data sourced from the invoicing and accounts receivable systems.

### **Transmission and distribution charges credit management and cash collection**

- 2.22. The activity of credit management and cash collection relates to the collection of transmission and distribution charges levied on shippers by Transco for use of its network. Underpinning these payment flows, from shippers to Transco, are credit arrangements that protect Transco from default by individual shippers.
- 2.23. The requirement for a credit management framework is governed by the Network Code. This framework covers guarantee requirements, credit rating requirements that shippers must meet, credit limit assignment, and cash call to keep indebtedness within secured credit limits.
- 2.24. Transco's internal business systems support this credit management service.

### **Other Network Code obligations**

- 2.25. Other Network Code activities cover various obligations specified by the Network Code such as:
- ◆ the management of user admission and termination;

- ◆ the validation of data at the interface with connected systems (through the CSEP database);
- ◆ Network Exit Agreements (NeXAs) supply meter points;
- ◆ must-read notifications, under which notification of failure of a supplier to provide a valid meter reading for NDMs; and
- ◆ the generation of meter point reference number (through the S&M database).

2.26. The S&M, Unique Sites and CSEP databases support these activities.

### **Transportation licence obligations**

2.27. Other obligations, which are not covered by the Network Code, arise from the GT licence. These include:

- ◆ the provision of an enquiry service so that customers can obtain details regarding their gas supply (e.g. Meter Point reference Number (MPRN), address details, identity of gas supplier);
- ◆ notification to shippers where no meter inspection has occurred in two years;
- ◆ processing of information when gas is illegally taken and, where appropriate, adjustment of invoices for theft;
- ◆ provision of standards of service and supply point information to the Authority;
- ◆ provision of MPRN address details to shippers and their agents; and
- ◆ provision of operational reports to shippers.

2.28. The S&M database, ConQuest and Internet Access to Data support these activities.

## **Gas nominations, operation and settlement**

- 2.29. Transco's residual energy balancing role involves responsibility for managing the system to accommodate desired input and offtake demand patterns as far as possible. To the extent it is required to, it adjusts flows by trading on the on the day commodity market (OCM) or through other mechanisms.
- 2.30. For the avoidance of doubt, Ofgem considers that under any approach, the role of the agency would not be to fulfil the role of residual energy balancer. Ofgem has made clear previously that this role will remain with Transco. However, the agency, under some approaches, could be responsible for provision of the AT-link system or its successor, Gemini, that Transco uses to acquire shippers nominations of their intended inputs and offtakes from the network over the gas day.
- 2.31. Transco considers nominations data to be key in performing its residual balancing role. In conjunction with other information received from offshore producers and from demand forecasts, this data allows Transco to assess the likely pattern of gas flows across the network and to plan accordingly, so that it can fulfil its role as gas balancer on an economic and efficient basis.
- 2.32. In addition to this information providing Transco with operational data, information on AT-link is also valuable to shippers for managing their positions and is used in the settlement process.
- 2.33. Transco is currently in the process of replacing its AT-link and RGTA systems with new systems known as Gemini. Details of the Gemini system are provided in Appendix 2.

## **NTS capacity**

- 2.34. For the avoidance of doubt, the NTS capacity activity relates, in this context, only to the potential provision of the Revised Gas Trading Arrangements (RGTA) platform. Under any approach, Transco, as owner and operator of the gas transmission network, would continue to auction and to buy back NTS entry capacity where appropriate. However, under some approaches, it would be possible for the agency to be responsible for the RGTA platform that allows the



capacity to be auctioned and to allow Transco to buy back capacity should it need to.

### **Demand derivation**

2.35. Demand derivation relates to:

- ◆ Long-term forecasting of demand across the system. This feeds into the network owner's decisions on investment in additional capacity; and
- ◆ Short-term forecasting that informs the network owner's operational decision making processes.

2.36. Ofgem's understanding is that these tasks are undertaken by bespoke internal Transco systems that have no links to shippers.

### **Demand estimation**

2.37. The demand estimation obligations are defined in Section H of the Network Code. The key features of these obligations include:

- ◆ the determination of end user categories (EUCs);
- ◆ the derivation of demand models and composite weather variables;
- ◆ the determination of Seasonal Normal Demand (SND);
- ◆ the development of algorithm parameters (ALPs/DAFs); and
- ◆ managing the demand estimation sub-committee.

2.38. The outputs from these processes feed into non-daily metered (NDM) load determination processes, determination of AQs, and determination of supply point capacities, which in turn feed into the assessment of shipper charges for transportation and energy balancing.

2.39. These activities are supported by the following systems: AT-link, RGTA, SC 95 and bespoke demand systems.

## **Emergencies**

- 2.40. There are a number of activities associated with gas emergencies, including:
- ◆ the provision of a 0800 national emergency number. Standard Condition 6 of the GT's licence requires the provision of a single service to receive emergency calls and the Gas Safety (Management) Regulations (GS(M)R) lists Transco as the provider of the national 0800 number; and
  - ◆ the management and resolution of local emergencies. This is generally undertaken by the local field force that will locate the source of the emergency and respond to the emergency accordingly.
- 2.41. The emergency and meter work system (E&MW) and local systems support this activity.

## **Site works**

- 2.42. Site works relates to the activities of a GT at a customer site and include:
- ◆ removing gas supply infrastructure at a customer site;
  - ◆ moving gas infrastructure; and
  - ◆ increasing the capacity of gas infrastructure at a site.
- 2.43. The Quotations and Storms systems support the provision of this activity.

## **Connections**

- 2.44. GTs have obligations under the Gas Act 1986, as amended, (the Gas Act) to provide connections to any party requesting a connection to their systems within specific circumstances<sup>5</sup>. To deliver this service, Transco has opted to a connections service provider to carry out all elements of the connections process, from the quotation through to provision of the connection.
- 2.45. The connections activity that could be included within the agency relates to the initial point of contact between suppliers and the network owner. If it were to

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<sup>5</sup> Section 9 and 10 of the Gas Act  
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be within the scope of the Agent, a supplier requiring a new connection would contact the agency who would, in turn, pass the request onto the appropriate DN. The alternative approach would be that the supplier would contact the relevant DN or other connection service providers directly.

- 2.46. The Quotations system and other internal bespoke systems support this activity.

### **Metering**

- 2.47. Under standard licence condition 8 of the GT licence, the meter provider of last resort obligation rests with the respective network owner. Metering is a competitive activity and the implementation of the review of gas metering arrangements (RGMA) project (scheduled for 12 July 2004) will facilitate suppliers seeking meter provision from a number of competing service providers. However, to the extent that competition may develop at different rates in different parts of the metering market, there is likely to be a requirement for a metering provider of last resort. The GT will undertake this role. If the Agent was to undertake this activity then a supplier requiring a new meter for a customer would contact the Agent, who would then route the request to the relevant DN as last resort meter provider.

- 2.48. Metering system separation will move this to the Rainbow system.

### **Network code development**

- 2.49. All signatories to the Network Code can propose modifications to the Code and as such contribute to Network Code development. Transco, as the relevant GT has obligations to ensure the development of the Network Code is consistent with its licence obligations. The activity of Network Code development relates to the development of policy change proposals and the drafting of associated modification proposals to the Network Code for consideration in the formal modification process that can be undertaken by any Code signatory.

### **Network code administration**

- 2.50. This activity is related to the administration of the modification process to the Network Code. Transco currently performs this obligation under its GT licence. This activity is effectively a secretariat function that has the following duties:

- ◆ to prepare reports on the modification proposals;
- ◆ to manage the consultation process, including chairing meetings (e.g. modification panel meetings) and issuing minutes of the meetings;
- ◆ to summarise responses to the consultation process; and
- ◆ to draft the legal text associated with the modification.

2.51. Currently, shippers can interface directly into NEMISYS enabling electronic submission of modification proposals and consultation responses.

### **Transportation charging development**

2.52. The development of transmission and distribution charging methodologies is an activity associated with the modification of the charging regime for the NTS and the LDZs respectively. Therefore, it is associated with the policy development and drafting of proposals for pricing consultations. Currently, this activity is discharged by Transco under standard condition 4A of its GT licence. Currently, all independent gas transporters (IGTs) have the similar charging arrangements for new properties connected from 1 January 2004. For properties connected prior to this date, IGTs have legacy charging arrangements that vary considerably between networks.

### **Transportation charging administration**

2.53. In the same way that modifications to the Network Code are administered, transportation pricing consultations also have an administration process, which includes:

- ◆ collecting respondents' views to the pricing consultation;
- ◆ summarising the consultation process; and
- ◆ preparing a final report on a change to the charging methodology.

## **IX interface**

- 2.54. The interface between the various Transco systems and shippers is known as the IX or information exchange. For any changes to occur to the IX shipper interfaces there currently needs to be either:
- ◆ an approval to a Network Code modification proposal; and/or
  - ◆ a change that is progressed through the UK Link Committee (which is currently chaired by Transco).
- 2.55. Under all options under consideration in this document, it is proposed the UK Link Committee will be chaired by the agency and/or the governance entity as appropriate. Approved modification proposals to the Network Code might require changes to the IX in the same way as they do today.

## 3. Objectives

- 3.1. This Chapter sets out the objectives that the Authority must fulfil when it decides whether to consent to the DN sales process. It additionally sets out Ofgem's objectives with respect to determining an appropriate set of agency and governance arrangements following a DN sale.

### **Regulatory approval process**

- 3.2. In order to dispose of a DN asset, Transco will require the consent of the Authority in accordance with amended standard condition 29 of its GT licence.<sup>6</sup> In deciding whether to give consent, the Authority must act in accordance with its statutory objectives and duties as set out in the Gas Act as well as other public law duties.
- 3.3. The principal objective, set out in section 4AA of the Gas Act, provides that the Authority is 'to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas'.
- 3.4. Having regard to these objectives, when deciding whether to consent to the disposal of one or more DNs, the Authority will assess, on the basis of the evidence available, whether it is likely that present and future customers' interests are protected.

### **Objectives of the agency and governance RIA**

- 3.5. When deciding on an appropriate agency and governance framework, Ofgem will need to consider its principal objective as set out above, as well as its general duties. In this context, Ofgem considers that its general duty relating to the need to promote efficiency and economy on the part of licence holders to promote the efficient use of gas conveyed through pipes as outlined in sub-section 4AA(5)(a) of the Gas Act, has particular relevance to the determination of

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<sup>6</sup> This condition also provides the Secretary of State with a power of veto over any proposal on the part of Transco to dispose of a transportation asset to the extent that it comprises a significant part of the gas conveyance system in Great Britain.

a agency and governance framework in the context of DN sales. In this respect, in discharging this duty it will be important for Ofgem to consider to what extent costs to consumers as a result of DN sales can be appropriately mitigated through the creation of agency and governance arrangements. Ofgem will also need to consider its general duties to ensure that all reasonable demands for electricity and gas are met and to secure a diverse and viable long-term energy supply.

- 3.6. In addition to meeting Ofgem's statutory duties, the post-sale industry structure must establish a relationship between the NTS and DNs that permits each network owner to fulfil its own statutory and licence obligations.
- 3.7. These include:
- ◆ the duty of each GT to develop and maintain an efficient and economical pipeline system (sub-section 9(1)(a) of the Gas Act); and
  - ◆ the duty of each GT to avoid any undue preference or undue discrimination in the terms on which it undertakes to convey gas (sub-section 9(2)(b).
- 3.8. Further, as set out in standard condition 4D of the GT licence, each GT has an obligation to ensure that it conducts its transportation business in a manner best calculated to secure that neither it nor its affiliates and related undertakings obtain any unfair commercial advantage, including, in particular, any advantage from a preferential or discriminatory arrangement. It will be important, in this respect, for Ofgem to consider the potential for discrimination by Transco in favour of any of its retained distribution businesses and whether or not agency and governance arrangements can be used to minimise the potential for this discrimination.
- 3.9. Ofgem will therefore need to consider each of these obligations and duties, as well as any others raised as being relevant through the consultation process, in determining an appropriate agency and governance framework and assessing the costs and benefits of each of the options set out in Chapter 5.
- 3.10. In addition, Ofgem will consider the experience of the electricity industry. In electricity, there is a relatively fragmented industry structure and different governance arrangements which support multiple distribution network

operators. When it makes a decision on the agency and governance arrangements that could apply in the gas industry, Ofgem will, where appropriate, take advantage of the lessons from electricity. However it is important, when drawing on the electricity experience, to keep in mind that the starting position in gas and electricity varies considerably and therefore comparisons may not always be appropriate.

- 3.11. In considering these obligations and duties Ofgem has identified a number of key issues that will need to be addressed in determining appropriate agency and governance arrangements. These are set out in the following Chapter.



## 4. Key issues

- 4.1. This Chapter outlines the key issues to be addressed when establishing the agency and governance arrangements to manage the relationship between the network operators and the shippers.
- 4.2. The key issues to be considered in relation to the agency are cost mitigation, effect on competition, accountability, quality of service, and funding arrangements. The key issues to be considered in relation to governance are non discrimination, transparency, inclusiveness, effectiveness and efficiency.
- 4.3. This Chapter also describes certain issues associated with the agency and governance arrangements that will need to be considered both going forward in the DN sales process and, subject to the sale of DNs proceeding, after the sale has occurred.

### ***Key issues for the agency***

#### ***Cost mitigation***

- 4.4. One of the main drivers for the establishment of an agency is to protect shippers and suppliers (and therefore consumers) from increased costs associated with inefficient industry fragmentation through, in particular, a requirement for each shipper to have a separate interface with each network owner.
- 4.5. In the absence of agency arrangements, costs could arise as a result of shippers and suppliers being required to develop different systems to deal with different DNs and the NTS. For instance, suppliers could be required to develop new systems to support different file formats for each DNs SPA processes. Shipper and supplier representatives have suggested that, in the absence of agency arrangements, the costs to consumers associated with industry fragmentation have the potential to be larger than any benefits to consumers associated with the sale of one or more DNs.
- 4.6. The agency arrangements should be designed to reduce costs by establishing, where appropriate, a single systems interface through which shippers and suppliers can manage their interactions with network operators. The extent to

which the potential for industry fragmentation is reduced will depend upon the scope of the functions performed by the agency. The options for the scope of the agency are set out in Chapter 5.

- 4.7. Any change from the status quo associated with DN sales will impose certain costs upon shippers that are considered in the cost benefit analysis. Shippers may incur a one-off cost in order to ensure that their data management and communications systems are able to interface with the systems adopted by the agency. For instance, there may be some minimal changes required to file formats at the shipper/agency interface. In addition, Ofgem expects that there will also be ongoing data validation costs that will be incurred by shippers. It would not be appropriate, however, in assessing the issue of costs and cost mitigation associated with potential DN sales, to include the costs associated with other reforms.

### ***Effect on competition***

- 4.8. In the absence of agency arrangements, the DN sales process has the potential to have an adverse effect on both wholesale and retail competition. Ofgem considers that inefficient industry fragmentation could discourage market entry and weaken competition, as, for example, suppliers might need to install different SPA systems for each DN.
- 4.9. The agency proposals seek to prevent any negative impact on competition by preserving a single uniform interface between network operators and shippers. The expected impact of the agency on retail and wholesale competition is discussed in more detail in Chapter 6.
- 4.10. Conversely, the agency could potentially weaken competition in metering and connections if it takes on functions that encourage shippers and suppliers to continue to use the incumbent service provider rather than considering alternative service providers.
- 4.11. To the extent that the Agent, as a monopoly, is solely responsible for delivering communication and settlements systems there is a risk that this could hinder innovation in, and the development of, new systems and technologies. This, of course, would be subject to any incentive arrangements that are placed upon the Agent through its governance framework.

## ***Accountability***

- 4.12. Ofgem considers that functions should be allocated between the NTS, DN and the agency in a way that ensures that responsibilities are defined clearly. In particular, it will be important to ensure that any arrangements clearly allocate responsibility for failure in the provision of services. In this respect, Ofgem considers that accountability and clarity in responsibilities should assist in providing clear incentives to parties undertaking these activities, which should reduce costs to industry, and therefore consumers.
- 4.13. It should be noted that accountability can either be achieved through arrangements whereby the owner of the network provides the services or through arrangements under which services are outsourced under contract, for example, to an Agent. In the latter case it, will be important to ensure that any contracting arrangements clearly allocate responsibilities for any failures in the provision of services.

## ***Funding for the remainder of the current price control***

- 4.14. Ofgem considers that the costs of establishing any agency should be funded by Transco from the existing revenue allowance in the current NTS and DN price controls. Ofgem does not consider that it is appropriate that any additional costs associated with the agency arrangements are passed through to consumers. Consequently, these costs are not considered in this RIA.
- 4.15. Ofgem considers that it would create transparency for future development if Transco represents the costs of the agency on the basis of activity based costing (ABC) analysis. An ABC assessment could form the core of shadow pricing for the various SPA products offered by the agency which could create the conditions, if appropriate, to remove these costs from the respective Transco and DN price controls at a future date if, for example, the agency were to become a separately licensed and regulated entity.

## ***Quality of service***

- 4.16. The creation of an agency will have important implications for the quality of services that are currently provided by Transco to shippers and suppliers. As noted in Chapter 2, careful consideration will need to be given to which services

are allocated to the proposed agency and the impact that this will potentially have on the quality of the services provided. Overall, Ofgem considers that there should be no deterioration in the quality of service and, indeed, the new arrangements should promote enhanced provision of these services.

- 4.17. In some instances, it may be the case that the services provided by the Agent could have otherwise been provided on a market or competitive basis, thereby enabling customers to benefit from the efficiencies and quality of service benefits associated with market provision. In other instances, the services provided by the Agent could be provided by DNs themselves. In these cases the creation of an Agent would itself have cost implications, as it would prevent customers obtaining any of the quality of service, and associated efficiency benefits that could have otherwise accrued through individual DNs providing these services in an environment of comparative regulation.
- 4.18. As such, whilst the creation of an Agent may assist in mitigating some costs, careful consideration will need to be given to the negative effects that allocating services to a monopoly Agent service provider may have on the quality of services that are provided.
- 4.19. Further, in the event that certain services are provided by an Agent on a monopoly basis, consideration will also need to be given to the mechanisms by which the quality (and indeed, going forward, the costs) of these services should be funded and regulated and the nature of any regulatory incentive arrangements that are developed.

### ***Key issues for governance***

- 4.20. The new governance arrangements should be designed in accordance with the following principles:
- ◆ **Non-discrimination.** At present, since it is the owner of the Network Code, Transco carries out the administrative processes associated with modifications to the Code. Going forward, it might no longer be appropriate for responsibility for these processes to reside with Transco alone as it might be possible for Transco to use its influence over the modifications process in a discriminatory manner. For instance, Transco

might seek to fast-track proposals that promote its commercial interests or to delay proposals that it does not support. The governance arrangements should avoid any undue discrimination between parties including between retained DNs and independent DNs. In order to achieve this it is important that decisions should be made by reference to predefined objectives, and that decision makers should have full access to all relevant information;

- ◆ **Transparency.** Decisions should be taken transparently. This means that information must be available to all affected parties and that discussion and analysis should be visible;
- ◆ **Inclusiveness.** There should be no exclusion of relevant information or viewpoints. Consequently, contributions should be allowed from all interested parties on key decisions;
- ◆ **Effectiveness.** Decision-making processes should balance the need for timely decision making and thorough consideration of issues; and
- ◆ **Efficiency.** Decision-making processes should not impose undue administrative costs on industry participants and should ensure that issues are resolved in a timely manner.

## ***Future issues***

- 4.21. There are a number of other issues associated with the agency and governance arrangements that are not intended to be resolved by this RIA. These issues will be considered either later in the workgroup process or at the next price control review in 2007/8. We briefly outline the nature of these issues.

### ***Issues to be considered by the workgroups***

- 4.22. A number of important aspects of the governance arrangements are yet to be considered by the workgroups. At a later point in the work programme, the workgroups will consider the following issues:
- ◆ the way in which changes to the Network Code are proposed, developed and decided;

- ◆ the process for making decisions required under the Network Code (including decisions by key committees such as the UK Link Committee);
- ◆ how to monitor and enforce compliance with the Network Code;
- ◆ how to facilitate resolution of disputes between participants under the Network Code; and
- ◆ how to manage the implementation of Network Code rules and processes.

4.23. The workgroups additionally need to consider the governance of the Agency. In particular, a number of parties are concerned that the establishment of multiple DN owners might hinder delivering the key objective of reform to the SPA arrangements. Given the importance of this work, the governance arrangements of the agency need to ensure that these reforms can be progressed in a timely manner.

4.24. Additionally, the workgroups have undertaken to look at ensuring that services that Transco currently provide to shippers and suppliers on an informal basis are maintained. In particular it may be necessary to codify some or all of the informal arrangements via the Network Code or the supply point administration agreement (SPAA).

4.25. It will be necessary to resolve these issues prior to the sale of one or more DNs. However, as these issues have not yet been fully addressed by the workgroups, they are not considered further in this RIA.

### ***Issues to be considered at the next price control review***

4.26. Since Ofgem does not intend to re-open the existing price control, the arrangements for agency and governance must conform to the current price control parameters. However, at the next price control review Ofgem might form the view that certain aspects of the arrangements should be amended in order to protect the interests of consumers. In particular, the following issues might be considered in 2007/8:

- ◆ funding of the Agent and Governance Entity;

- ◆ ownership of the Agent and Governance Entity;
- ◆ governance of the Agent and Governance Entity, including governance of SPA services; and
- ◆ SPA systems development.

- 4.27. It is important to note that in allocating services to an Agent and Governance Entity there is a risk that, as there would be no competitive constraints, the costs associated with the provision of these services could increase over and above efficient levels. Further, there is also a risk that service quality could deteriorate.
- 4.28. As such, Ofgem considers that it will be important to ensure that the Agent and Governance Entity is effectively regulated with appropriate incentives to manage costs efficiently and at the same time ensure service quality is maintained.
- 4.29. The manner in which the Agent and Governance Entity is regulated will be to some extent dependent on its own governance and ownership arrangements. For example, it may be preferable for the purposes of preventing discrimination between independent and retained DNs that the Agent and Governance Entity be created as a separately owned and licensed body.
- 4.30. In this case, the Agent and Governance Entity could be a not-for-profit organisation<sup>7</sup> or it could be a profit making organisation and receive its own allowed revenue and incentives through a price control. Any price control would be set on a periodic basis under the entity's licence and would enable the entity to capture the benefit of any cost savings achieved during the price control period.

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<sup>7</sup> This would be similar to the arrangements for ELEXON in the electricity market, although it is formed under the BSC rather through its own licence.

## 5. Options

5.1. In this Chapter we discuss the options considered as part of this RIA on both agency and governance issues. This Chapter has the following Sections:

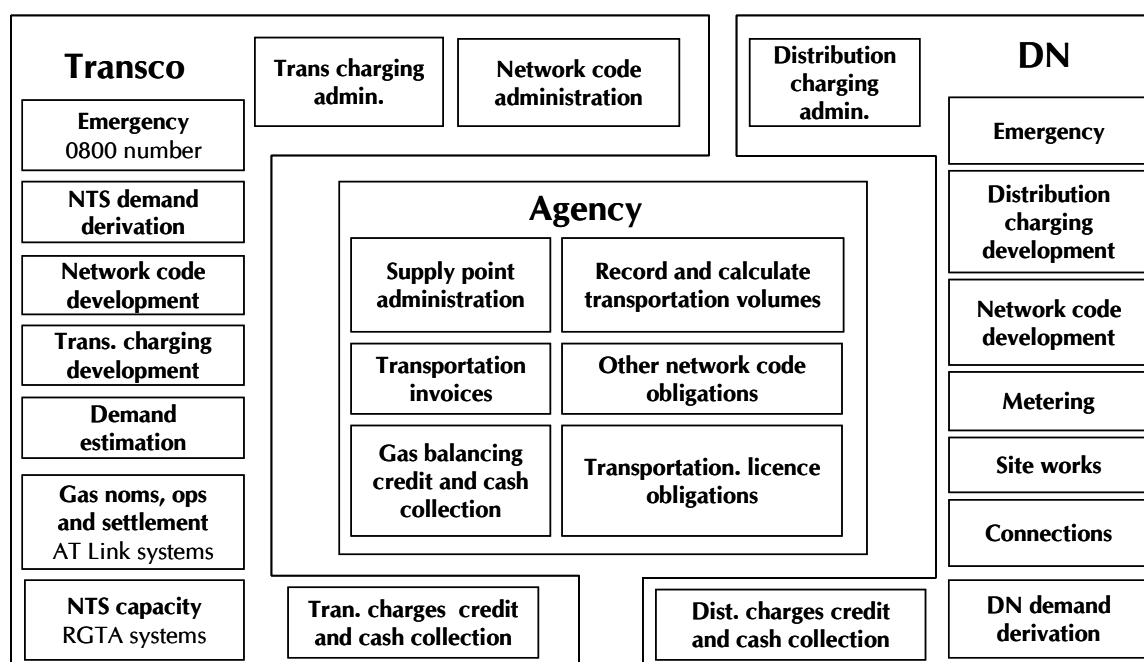
- ◆ a discussion of the options for the scope of the Agent; and
- ◆ a discussion on the options for governance.

### ***Option A: NGT's initial proposal***

5.2. In this Section we describe Option A which represents Transco's initial proposal. The split of activities in this Option has been assessed in detail by the Agency Work Group.

5.3. The split of activities between Transco, Retained and Independent DN's and Agent under Option A is shown in Figure 3. In this context, the attribution of activities refers to the party actually delivering that service and not the party who will have the primary obligation in relation to that service.

**Figure 3: Split of activities under Option A**



5.4. We briefly describe the range of activities to be undertaken by the agency,

Transco NTS and the DN's in the following subsections:



### **Activities undertaken by the agency under Option A**

5.5. Under Option A, the agency acts as a subcontractor to the NTS and DNs to provide the following services:

- ◆ supply point administration;
- ◆ the recording and calculating of transportation volumes;
- ◆ the provision of transportation invoices for energy balancing, transmission and distribution charges;
- ◆ the management of energy balancing credit arrangements and cash collection for energy balancing;
- ◆ the other Network Code obligations as detailed in Chapter 2; and
- ◆ the transmission licence obligations as detailed in Chapter 2.

### **Activities undertaken by DNs under Option A**

5.6. Under Option A, each DN owner would undertake the following activities in relation to its network:

- ◆ distribution charges cash collection and management of credit arrangements for its distribution charges;
- ◆ the development of distribution charging methodology modifications;
- ◆ the administering of the process of changes to the distribution charging methodology for use of its network;
- ◆ the 'last resort' provider of metering facilities on its network;
- ◆ the point of contact for shippers and anyone else requesting a connection requiring customer connection to its network;
- ◆ site works for sites connected to its network;
- ◆ demand derivation for its network;

- ◆ development of the Network Code, in that it would raise modifications to the Network Code; and
- ◆ the provision of a field force to resolve emergencies.

### **Activities undertaken by Transco under Option A**

5.7. Transco, as owner and operator of the NTS, would, under Option A, undertake the following set of activities in addition to its other network activities:

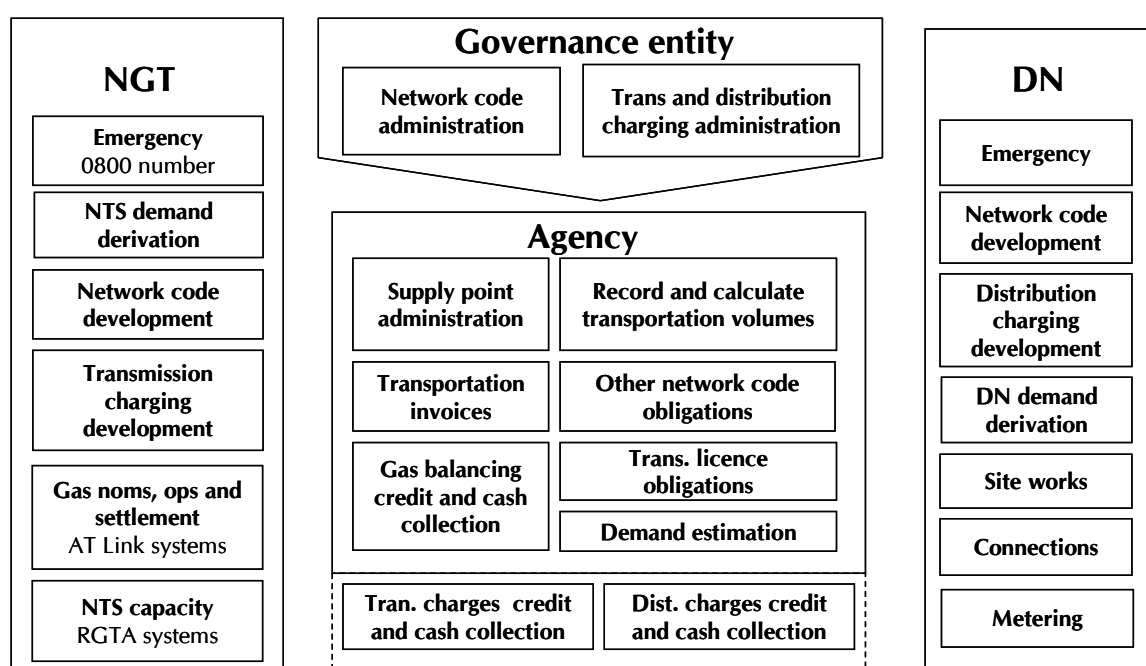
- ◆ transmission charging methodology development;
- ◆ Network Code development;
- ◆ demand derivation for the NTS;
- ◆ demand estimation;
- ◆ transmission charging methodology administration;
- ◆ Network Code administration;
- ◆ provision of the 0800 emergency number;
- ◆ transmission charge credit management and cash collection;
- ◆ AT-link systems that support the provision of settlement and operational data from shippers to Transco; and
- ◆ RGTA systems that support the purchase and sale of NTS capacity.

### ***Option B: Introducing a Governance Entity***

5.8. In this Section we describe Option B. This model was developed in the work group discussions. Under Option B, a 'Governance Entity' is introduced with the aim of addressing potential concerns surrounding Transco's ability to discriminate in the Network Code modification process post DN Sales. Demand estimation would additionally become an Agent activity rather than a Transco activity, as the workgroups considered that this was a settlement activity and that there were some benefits to ensuring that the estimation methodology used was consistent across all networks. Transco do not consider that this is the case and

that the demand estimation function would be more appropriately conducted by Transco. The workgroup considered two alternatives under Option B – one where transmission and distribution charges cash and credit collection would be included in the scope of the Agent, and another where the responsibility would rest with the respective network owners. The split of activities is as shown in Figure 4 and the two main features it introduces, the Governance Entity and transmission and distribution cash collection and credit arrangements, are discussed subsequently.

**Figure 4: Split of activities under Option B**



## Governance Entity

- 5.9. As explained above, the key difference between Option B and Option A, presented in the previous Section, is the creation of a centralised ‘Governance Entity’. Given the current funding arrangements (discussed in Chapter 4), it would, most probably, only be possible until 2007/8 for the Governance Entity to be owned by Transco, Transco’s Retained DNs (RDNs) and Independent DNs (IDNs). The initial proposal is that the Governance Entity would be an unincorporated joint venture between Transco, RDNs and IDNs. Careful consideration needs to be given in the workgroup process to the detail of these arrangements including the extent to which legal and structural separation is appropriate for the Governance Entity.

- 5.10. The Governance Entity would be responsible for the administration of both Network Code modification proposals and changes to transmission and distribution charging methodologies. The Governance Entity would perform a secretariat function, similar in part to the role performed by ELEXON for the electricity balancing and settlement arrangements. As such, it would be responsible for progressing all modification proposals through the governance process, chairing all meetings, preparing all reports (including legal text) and the implementation arrangements for modification proposals.

### **Transmission and Distribution charges, credit and cash collection**

- 5.11. As explained above, the workgroups considered two variants on Option B. As part of the work group process, shippers were asked to provide Ofgem with information on the potential costs they would incur if the Agent were to undertake this activity or whether each network operators should undertake the task for their own network charges. Shippers accepted, through the workgroup discussions, that the costs associated with IDNs managing credit and cash collection were not material; nevertheless shippers indicated a preference for transmission and distribution charges, credit and cash collection to be included in the scope of the Agent. Transco, conversely, did not consider that this was appropriate, as it believed network owners would prefer to have responsibility for the relationship with its customers.

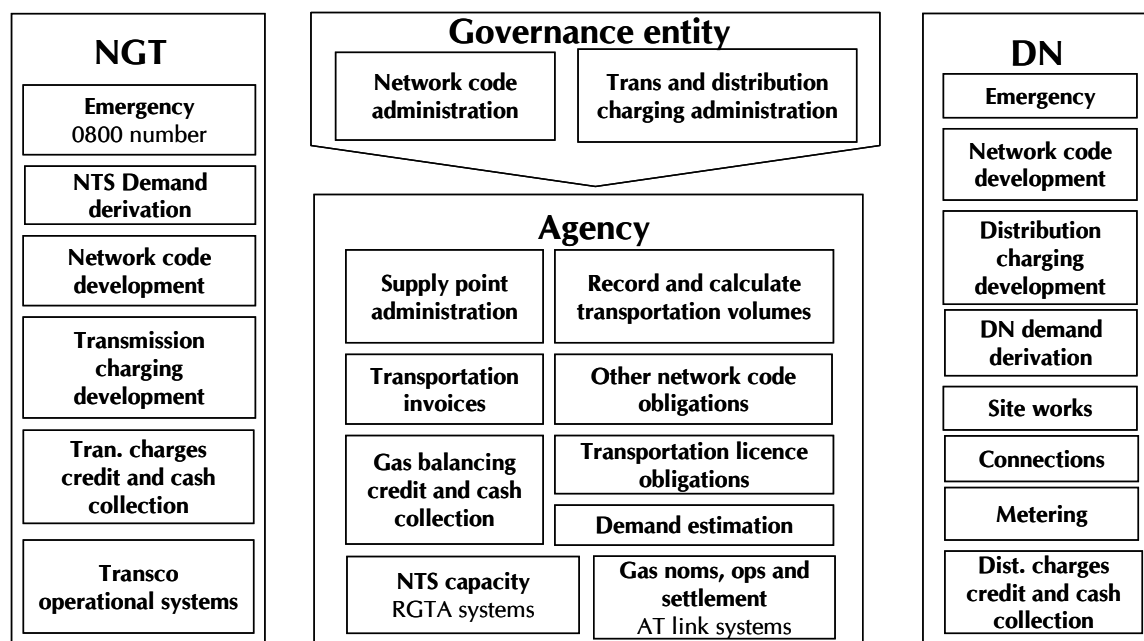
### ***Option C – Including AT-link and RGTA in the Agency***

- 5.12. This Section describes Option C. This Option arose following the workgroup discussions in which some shippers expressed concern that, under Option B, the AT-link and RGTA systems would remain owned and operated by NGT. Shippers considered that both RGTA and AT-link were an integrated part of the UK-link systems which were more associated with settlement activity rather than system operation for the NTS. Shippers expressed a view that it was desirable to transfer all UK-link systems to the Agent to protect against, in their view, future inefficient fragmentation. Following these discussions, Ofgem has developed Option C. For the avoidance of doubt, in this Section we are only discussing the operation of the IT systems and processes and are not discussing the Agent conducting Transco's system operation role. Hence, as Figure 5 indicates,

Transco would require alternative operational systems to those currently used.

The other key features of Option C are also set out in Figure 5.

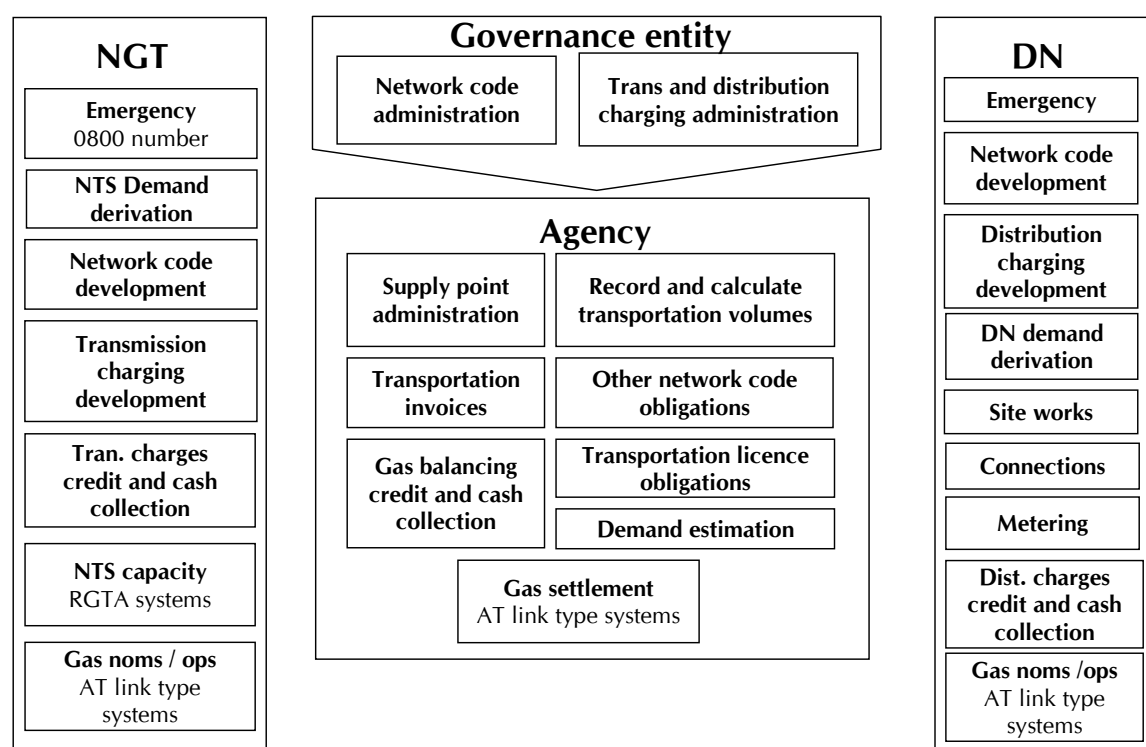
**Figure 5: Option C - incorporating RGTA and AT Link systems**



## ***Option D – Allocating systems with responsibilities***

- 5.13. The discussions that have occurred both in the work groups and with shippers and Transco have highlighted that AT-link contains information that both Transco and shippers use operationally and, additionally, information that is used in the settlement process. Having considered these issues carefully, as well as the need to ensure that there is clear accountability for system operation tools, Ofgem has developed an Option D. The split of activities under Option D is set out in Figure 6, below.

**Figure 6: Scope of activities of Agent under Option D**



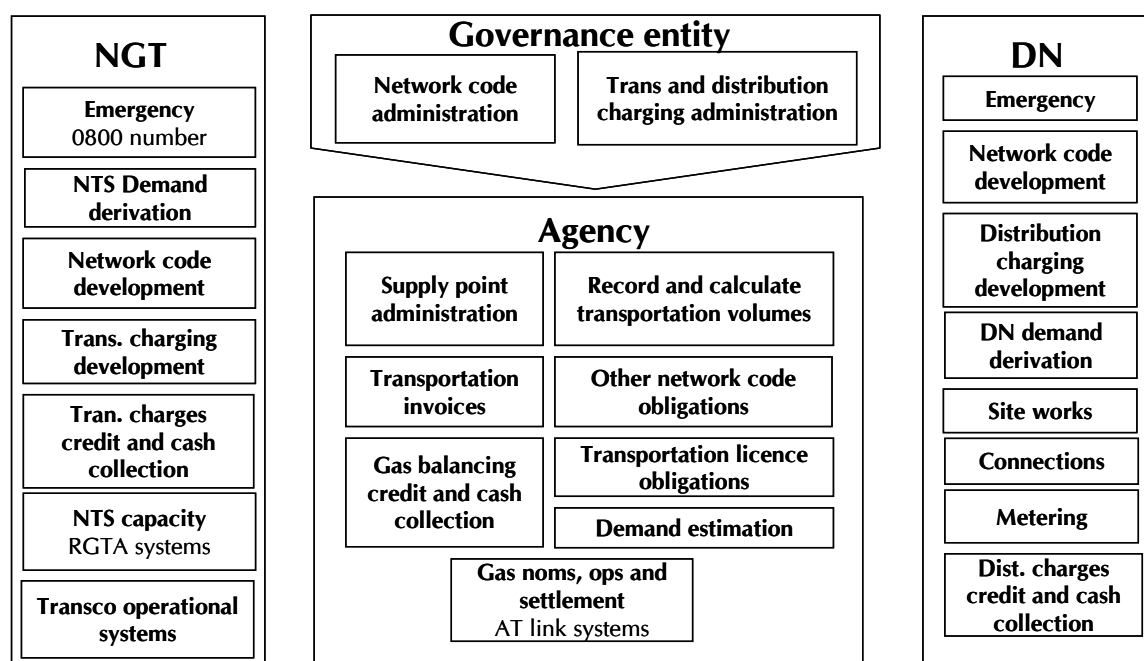
- 5.14. Under Option D, new systems would be developed to split the information currently contained within AT-link between operational data and data that are primarily used in settlement, with the former being placed with the respective system operators, namely Transco's NTS business, RDNs and IDNs, and the latter being placed in the agency. Under this approach, the RGTA systems associated with NTS capacity provision would be under the operation of Transco, as operator of the NTS.
- 5.15. This approach is closest to the electricity market model, in which operational data, in the form of Final Physical Notifications (FPNs), are received directly by NGC as system operator and all settlement data are passed to Logica, as an agent to ELEXON.

### ***Option E – including RGTA systems with the NTS and AT-link with the agency***

- 5.16. In developing Option D, Ofgem recognises that, whilst this option may have accountability-type advantages of ensuring that systems are allocated according to responsibilities, it would necessitate the development of new systems to

separate the operational and settlement activities of AT-link. Ofgem recognises that the costs associated with this system development might be high, as shippers (and therefore ultimately customers) would have to develop systems to interface with both the NTS and DNs. Taking these costs into consideration, Ofgem has developed a further approach, Option E, in which the NTS would retain responsibility for the RGTA systems, whereas AT-link would become an agency function. For the avoidance of doubt, in this Section we are only discussing the operation of the IT systems and processes and are not discussing the Agent conducting Transco's system operation role. The key features of this are set out in Figure 7 below.

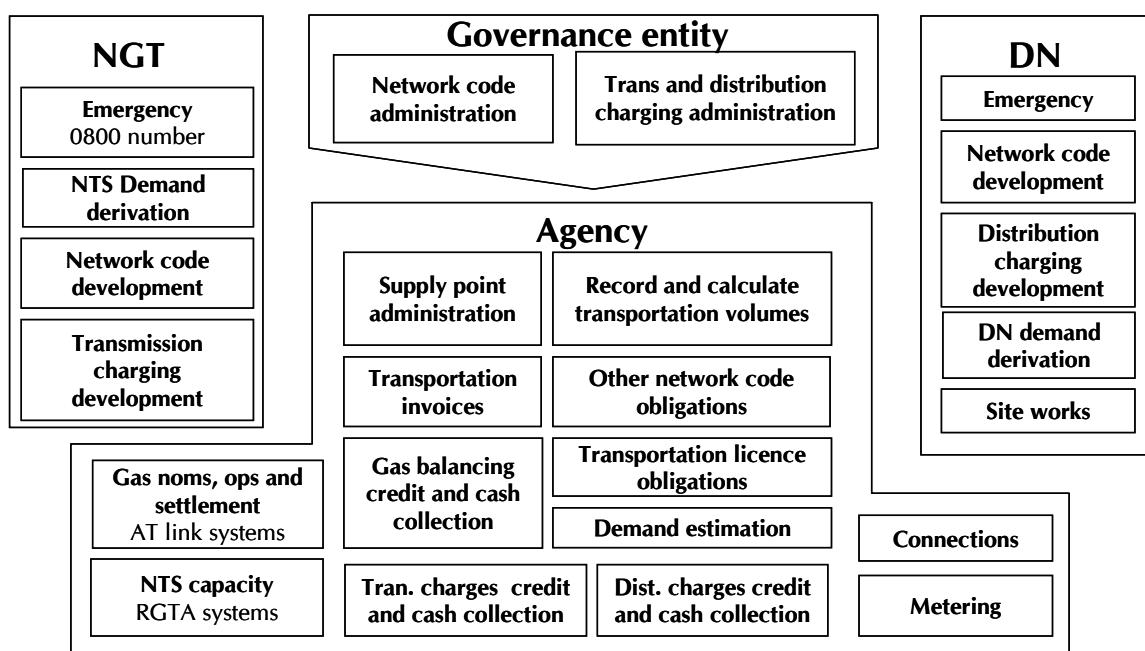
**Figure 7: Split of activities under Option E**



## ***Option F: Broadest agency***

5.17. In this Section we describe Option F, in which the scope of agency would be the broadest possible. Figure 8 sets out the split of activities under this approach.

**Figure 8: Split of activities under Option F**



5.18. In addition to the RGTA and AT-Link systems and transportation cash collection and credit arrangements being incorporated within the role of the agency, under Option F, the agency would also take on the activities of connections and metering as described in Chapter 2.

## ***Network Code and charging methodology governance options***

5.19. The previous Sections of this Chapter outlined potential options for the scope of the agency. In addition to these cost mitigation measures, the work groups have also discussed whether it is appropriate to restrict the governance arrangements for the Network Code and for each network's charging methodology arrangements. This could be achieved, for example, by prohibiting modifications to the Network Code or charging methodologies that result in divergence between networks, so as to limit future fragmentation which might arise as a consequence of DN Sales.

### ***Options under consideration***

5.20. Two main possibilities exist associated with the governance arrangements post DN Sales. This section describes the two main options that were developed and



discussed as part of the workgroup process, and are considered in the cost benefit analysis in Chapter 7.

### **Option – Unrestricted governance**

- 5.21. Under this option, the governance arrangements would operate as today. The Authority would consider each modification proposal against the relevant objectives of the Network Code. These objectives are:
- a. the efficient and economic operation by the licensee of its pipeline system;
  - b. so far as is consistent with (a), the efficient discharge of its obligations under the licence;
  - c. so far as is consistent with (a) and (b), the securing of effective competition between relevant shippers and relevant suppliers; and
  - d. so far as is consistent,(with its other obligations) the provision of reasonable economic incentives for relevant suppliers to secure that domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers.
- 5.22. Consistent with the Authority's obligations,<sup>8</sup> if a modification proposal is significant the Authority will issue an Impact Assessment (IA) prior to making its determination. This IA would be consulted upon with all interested parties. At the end of the consultation period after fully considering all responses, the Authority would reach its determination on the modification proposal and issue a letter explaining the reasons for its decision. This decision is subject to Judicial Review.
- 5.23. Standard Condition 4A of the GT licence sets out processes through which a GT may propose changes to its charging methodology. Following a pricing consultation process with industry participants, the relevant GT is able to recommend a proposed change, following which Ofgem has 28 days in which to veto the proposal. In assessing a proposal, Ofgem will have regard to the

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<sup>8</sup> These obligations are contained in section 5A of the Utilities Act  
Agency and governance arrangements – Regulatory Impact Assessment  
Office of Gas and Electricity Markets

relevant charging methodology objectives set out in Standard Condition 4A, as well as its wider statutory duties.

- 5.24. In addition to the checks and balances set out above, the Energy Bill also provides for appeals to be made to the Competition Commission on Authority decisions on certain industry codes. The precise details of these provisions are still being considered by Parliament.

### **Option – Restrictive governance**

- 5.25. This option would provide the same checks and balances as outlined above. This would require that the Authority: assess each modification against the applicable objectives of the Network Code and the charging methodologies; conduct an RIA for all significant decisions; and that Authority decisions could be subject to appeal either through judicial review or (subject to the Energy Bill becoming law) the Competition Commission.
- 5.26. In addition to these checks and balances, this option would introduce a new relevant objective that would *explicitly* require the Authority to consider the costs of potential industry fragmentation.
- 5.27. This option was considered by the industry workgroups and dismissed. The workgroups considered that the provisions would either be interpreted by the Authority as if there were no restrictions in place, if the Authority was in favour of divergence, or such that no divergence would be allowed, which would stifle innovation and potentially mean that the full customer benefits from DN Sales could not be realised. The workgroups considered that this uncertainty could ultimately harm customers' interests.
- 5.28. However, Ofgem considers that it might be appropriate for any new Governance Entity that might be formed to include in its reports on both modifications to the Network Code and charging methodology changes a section that assesses fragmentation issues. This would be similar to the reports that Transco complete which consider the gas – electricity interactions.

## 6. Competitive and environmental impacts

- 6.1. This Chapter considers the potential for broader industry impacts associated with the agency and governance arrangements. It considers the potential impact on wholesale and retail competition, the environment and distributional effects.

### ***Competition***

- 6.2. A key function of the Agent is to limit the opportunities for inefficient industry fragmentation associated with having multiple DN owners. As discussed below, the agency is intended to protect both retail and wholesale competition.

### ***Wholesale competition***

- 6.3. The DN sales process gives rise to a risk of industry fragmentation which presents some risks to wholesale competition. Fragmentation could increase shippers' costs if shippers are required to develop different systems interfaces to deal with different DNs. For instance, they could be required to deal with multiple access protocols, file formats, and/or data requirements. Ofgem considers that inefficient fragmentation could discourage market entry and weaken wholesale competition. The agency is intended to prevent these negative impacts on wholesale competition by preserving a single uniform interface between network operators and shippers.
- 6.4. The Governance Entity could potentially have a positive impact on wholesale competition if it leads to improved change management and governance arrangements. These impacts are discussed further in the context of retail competition (see paragraph 6.8).
- 6.5. Conversely, a potential benefit of fragmentation is that comparative regulation might provide additional incentives on DNs for innovation which might enhance competition. For instance, were DNs to have responsibility for collecting nominations data, there may be opportunities for enhancements to the current processes that could be encouraged through fragmentation of ownership.

## ***Retail competition***

- 6.6. The DN sales process also presents some risks to retail competition. For instance, if the DNs were responsible for SPA there is a risk that the process for customer switching could become non-uniform over time. This could impact adversely on retail competition in two ways:
- ◆ fragmented switching arrangements might increase the change of supplier failure rate, as suppliers interact with a range of different systems and process. The consequent bad publicity might impact adversely on customer switching rates; and
  - ◆ fragmentation could also increase suppliers' costs if suppliers are required to develop different systems interfaces to deal with different DNs. Ofgem considers that this would discourage market entry and weaken retail competition.
- 6.7. Ofgem considers it important that suppliers should not have to engage with significantly different processes in order to transfer customers situated on different networks. The Agent is intended to prevent these negative impacts on retail competition by preserving a single uniform interface for the SPA register and other systems.
- 6.8. The Governance Entity could potentially have a positive impact on retail competition if it leads to improved change management relative to the current arrangements. Further, careful consideration needs to be given to whether shippers and suppliers a role in the governance of key processes via the SPAA. This could provide better incentives for the Agent to support change and improve services levels.

## ***Environment***

- 6.9. Ofgem does not anticipate any environmental impacts associated with the establishment of the Agency.

## ***Distributional impact***

- 6.10. In developing the agency arrangements, it will be important to ensure that service quality standards are maintained for all customers. Consequently, Ofgem does not anticipate any distributional impacts associated with the establishment of the agency. Rather, through its governance arrangements the Agent should ensure that services are provided consistently across all DNs.
- 6.11. Option F, which has a relatively broad role for the Agent, has a lower potential for different service standards between DNs. However, this Option also limits potential opportunities for new DN owners and managers to innovate in ways that improve service standards and additional may limit the accountability for delivery of the services.

## 7. Costs and benefits

- 7.1. This Chapter evaluates the costs and benefits of each option for determining the scope of the proposed agency arrangements.
- 7.2. As well as assessing the costs and benefits of each option, we have also assessed the costs and benefits that would result were DNs to be sold without the establishment of the Agency. This RIA adopts this, 'no agency', Option as the base case, against which the options presented in Chapter 5 are assessed.
- 7.3. This Chapter has seven Sections, in which we:
- ◆ present our assessment of the costs and benefits of the 'no agency' Option; and
  - ◆ present our assessment of the costs and benefits of each of the Options A to F.
- 7.4. To gain a greater understanding of the costs of the various options, Ofgem conducted a survey of market participants. The pro forma that was sent to market participants is attached in Appendix 1. The information that Ofgem received from that survey (presented so as to preserve the confidentiality of respondents) is presented in Chapter 8. The following Chapter is a qualitative assessment, although based, in part, on responses to the questionnaire.
- 7.5. In the qualitative assessment we have used ticks and crosses to summarise Ofgem's view of each option against the key issues set out in Chapter 4. Each key issue is considered independently. Hence, the number of ticks or crosses should be interpreted as Ofgem's view of the magnitude of the costs or benefits relative to other options for that key issue.

### ***'No agency' Option***

- 7.6. Under this option, no Agent would be established following the sale of a DN. We have assumed that the allocation of responsibilities between the NTS and DNs would be the same as under Option A, however, each network operator would be responsible for managing all its own systems, including those for supply point administration. Transco NTS would manage the Network Code

change process arrangements whilst each network operator would both develop its own pricing methodologies and manage the associated change processes.

- 7.7. The costs and benefits of this option and a summary are set out in the subsections below.

## **Costs**

- 7.8. Ofgem has identified the following potential costs associated with the 'no agency' Option:

- ◆ **Undue discrimination in the handling of Network Code modification proposals.** As the sole network owner Transco currently has responsibility under its GT licence for administering the Network Code. If Transco's proposed sales go ahead, rather than one network owner there will be multiple network owners. This creates a potential risk that Transco could delay or hinder administrative processes on proposals that it does not favour or act in a biased manner with its preferred proposals over proposals by other network owners. Ofgem would, of course, have a regulatory safeguard against this form of undue discrimination as Transco has various statutory and licence obligations to act in non-discriminatory manner. However, if this potential concern was significant it would represent a cost and it is, arguably, better to address this risk ex-ante than ex-post through enforcement action;
- ◆ **Distribution charging methodologies (DCM) governance fragmentation.** Under this approach, each network owner would be responsible for managing its own pricing methodology. Some shippers were concerned that, compared with the arrangements today, where there is one principal set of pricing arrangements, having each DN manage its own DCM would increase their costs. Shippers were additionally concerned that, through fragmenting the DCM governance arrangements, there would be an increased risk of inefficient fragmentation of charging methodologies across DNs.

However, under the GT licence all changes to DCM's have to be sent to the Authority for its consideration. The Authority then has 28 days to decide whether it is appropriate to veto proposed changes. Ofgem

therefore considers that there are sufficient safeguards through the regulatory approval process to prevent inefficient fragmentation of charging methodologies. However, we recognise that having to deal in a decentralised way to proposed changes to DCM's might result in higher levels of costs, although our assessment of these costs is that they are unlikely to be material;

- ◆ **settlement and operational system fragmentation.** Under the 'no agency' Option all operational and settlement systems would fragment to be owned and operated by the respective network owners, either NTS or DN. This is likely to result in very high costs to shippers, and ultimately some of these costs might be passed through to customers, as shippers would have to create numerous new interfaces for each of the networks;
- ◆ **SPA systems fragmentation.** Under the 'no agency' Option, there is a risk that the SPA systems could fragment. For instance, each network owner could develop slightly different transfer protocols and require different interfaces with each shipper, with the potential for shippers to incur very large costs;
- ◆ **retail and wholesale competition.** For reasons set out in Chapter 6, the 'no agency' Option gives rise to serious concerns in respect of retail and wholesale competition. It has the potential to create a barrier to entry in wholesale and retail markets and could also discourage customers from switching; and
- ◆ **fragmentation of credit management and cash collection.** The requirement to pay each network owner directly under this Option will lead shippers to incur additional costs associated with separate payment flows to each network owner. Additionally, shippers would have to subscribe to each network's credit arrangements. Typically, this will require letters of credit to support a shipper's credit worthiness with consequent additional cost relative to the current arrangements in which only a single letter of credit to Transco is required for all network charges. However, Ofgem does not consider that this is likely to be a material cost, as shippers frequently need to put arrangements in place with new counterparties.



## **Benefits**

7.9. Ofgem has identified the following potential benefits associated with the 'no agency' Option:

- ◆ **accountability of credit and cash collection arrangements.** Under the 'no agency' Option, each network operator would be responsible for its own shipper settlement interfaces and credit management. Consequently, Ofgem considers that accountabilities would be clearly defined under this option;
- ◆ **competition in metering.** Under the 'no agency' Option, shippers and suppliers must deal directly with the relevant DN in relation to the meter provider of last resort. This is likely to have a marginally positive impact on competition, as it will oblige purchasers of metering services to consider actively which metering provider they will be using;
- ◆ **competition and accountability in connections.** By ensuring that each DN is responsible for connections, there would be clear accountability for connections, where competition has not yet developed. In sectors of the connections market where competition is more established, the DN sales process is likely to encourage new entry into the connection service provider market; and
- ◆ **quality of service.** In some instances it may be the case that the services provided by the Agent could otherwise have been provided on a market or competitive basis, thereby enabling customers to benefit from the efficiencies and quality of service benefits associated with market provision. In other instances, the services provided by the Agent could be provided by DNs themselves. In these cases, the creation of an Agent would not be costless, as it would prevent customers obtaining any of the quality of service and associated efficiency benefits that would have otherwise accrued were these services to be provided in an environment of comparative regulation. Hence, a benefit of this option is that these potential benefits would be able to be fully captured.

## ***Evaluation of costs and benefits***

7.10. In Table 7.1 below, we summarise the costs and benefits of the ‘no agency’ Option.

**Table 7.1: Summary of costs and benefits of the ‘no agency’ Option**

Issue	Qualitative assessment
<b>Accountability</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ Non competitive connections</li> </ul>	<p>✓✓</p> <p>✓✓✓✓</p> <p>✓</p>
<b>Cost mitigation</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ SPA systems</li> <li>◆ DCM governance arrangements</li> </ul>	<p>×</p> <p>×××</p> <p>××××</p> <p>×</p>
<b>Non- discrimination in modifications process</b>	<p>×</p>
<b>Competition</b> <ul style="list-style-type: none"> <li>◆ Wholesale &amp; retail</li> <li>◆ Metering</li> <li>◆ Connections</li> </ul>	<p>××××</p> <p>✓</p> <p>✓</p>
<b>Quality of service</b>	<p>✓✓✓✓</p>

## ***Option A: NGT’s initial proposals***

7.11. As set out in Chapter 5, under Option A the agency would act as a sub-contractor to network owners for the provision of a range of services. This would include providing and maintaining a supply point register, recording and calculating transportation volumes and providing transportation invoices. The agency would not be responsible for administering the process associated with Network Code modifications or pricing methodology change proposals. Instead, these functions would be retained by the relevant networks.

7.12. We set out our assessment of the costs and benefits of this option in the following Subsections.

### ***Costs***

7.13. Ofgem has identified the following potential costs of Option A:

- ◆ **undue discrimination in the handling of modification proposals.** As with the 'no agency' Option there is, potentially, a risk that Transco could delay or hinder administrative processes on proposals that it does not favour or act in a biased manner in favour of its proposals against those from other network owners;
- ◆ **fragmentation of distribution charging methodology governance arrangements.** As with the 'no agency' Option there is a risk of some limited costs associated with a fragmented series of DCM governance arrangements;
- ◆ **fragmentation of credit and cash collection.** As with the 'no agency' Option there is the risk of some costs associated with credit management and payment arrangements; and
- ◆ **AT-link and RGTA systems fragmentation.** In the view of some shippers, the fact that the AT-link and RGTA systems would remain within Transco's NTS remit under this Option, would potentially increase the risk of costly and inefficient changes to settlement systems over time. However, the extent to which these changes could occur is dependent on the governance arrangements and Ofgem considers that with effective governance arrangements these costs should be avoidable.

## ***Benefits***

7.14. Ofgem has identified the following potential benefits associated with Option A:

- ◆ **accountability for credit and cash collection arrangements.** As with the 'no agency' Option, each network operator would be responsible for its own credit management with potential benefits to customers;
- ◆ **accountability for settlement and operational systems.** Under Option A, Transco would retain responsibility for the AT-link and RGTA systems. This would have the potential benefit of ensuring clear accountability for the continued provision of these systems;
- ◆ **integrated SPA systems.** Under Option A (and all other subsequent options discussed in this Chapter), the SPA systems would be under

control of the Agent. Hence, there would be no scope for fragmentation of the systems, ensuring that shippers would not incur the potentially large systems and process change costs that could arise were the systems to fragment;

- ◆ **retail and wholesale competition.** For reasons set out in Chapter 6, the creation of an agency and a single body that is responsible for SPA processes across the NTS and DNs is likely to have positive benefits in terms of promoting retail and wholesale competition;
- ◆ **competition in metering.** Consistent with the 'no agency' Option, there may be a positive marginal benefit for having metering outside of the scope of the agency arrangements;
- ◆ **competition and accountability in connections.** As with, the 'no agency' Option, there are benefits both in terms of accountability and in competition of not including connections within the scope of the Agent's activities; and
- ◆ **quality of service.** Whilst the creation of an Agent may assist in mitigating some costs, careful consideration will need to be given to the negative effects that allocating services to a monopoly Agent service provider might have on the quality of services that are provided. In the event that certain services are provided by an Agent on a monopoly basis, consideration will also need to be given to the mechanisms by which the quality (and indeed, going forward, the costs) of these services should be funded and regulated. However, Ofgem believes that it would be possible to provide appropriate incentives to ensure quality of service.

### ***Evaluation of costs and benefits***

7.15. In Table 7.2, we set out a qualitative assessment of the costs and benefits of Option A.

**Table 7.2: Summary of costs and benefits of Option A**

Issue	Assessment
<b>Accountability</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ Non competitive connections</li> </ul>	<ul style="list-style-type: none"> <li>✓✓</li> <li>✓✓</li> <li>✓</li> </ul>
<b>Cost mitigation</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ SPA systems</li> <li>◆ DCM governance arrangements</li> </ul>	<ul style="list-style-type: none"> <li>✗</li> <li>✗</li> <li>✓✓✓✓</li> <li>✗</li> </ul>
<b>Non-discrimination in modifications process</b>	<ul style="list-style-type: none"> <li>✗</li> </ul>
<b>Competition</b> <ul style="list-style-type: none"> <li>◆ Wholesale &amp; retail</li> <li>◆ Metering</li> <li>◆ Connections</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> <li>✓</li> </ul>
<b>Quality of service</b>	<ul style="list-style-type: none"> <li>✓✓✓</li> </ul>

## ***Option B: Introducing a Governance Entity***

7.16. Under Option B, the Agent would provide and maintain a supply point register, record and calculate transportation volumes and provide transportation invoices. In addition, a Governance Entity would be responsible for administering the process associated with Network Code modifications or pricing methodology change proposals. Whether the network operator itself or the Agent collects payment for transportation charges and undertakes the associated credit arrangements are variants of this Option.

7.17. The case where the credit management and cash collection rest with the respective network owners is termed Option B1, whereas Option B2 would incorporate the activity of cash collection and the respective credit arrangements within the agency.

### ***Costs***

7.18. Ofgem has identified the following potential costs associated with Option B:

- ◆ **accountability** for credit and cash collection. Option B2, in which the Agent would undertake the role of managing credit and collecting payment, has a number of potential drawbacks:
  - ◆ there is a potential risk that the Agent would not be able to allocate the appropriate credit risks to the appropriate counterparties. Hence, credit risk would be smeared across the entirety of the market. This risks both reducing the accountability of the credit management arrangements and potentially increasing the overall costs of the activity; and
  - ◆ it would not be possible to assess the efficiency of DN's credit arrangements through comparative regulation – all DNs would, by definition, take the same approach to credit arrangements;
- ◆ **fragmentation of credit and cash collection.** Conversely, Option B1 would have the disadvantage that each shipper would have to establish separate payment and credit processes for each set of independent distribution charges. However, as explained in the 'no agency' Option, Ofgem does not consider that this is likely to be a material cost, as shippers frequently need to put arrangements in place for new credit counterparties; and
- ◆ **AT-link and RGTA settlement systems fragmentation.** In the view of some shippers, the fact that the AT-link and RGTA systems would remain within Transco's NTS remit under this Option, would potentially increase the risk of costly and inefficient changes to settlement systems over time. However, as explained in Option A, the extent to which these changes could occur is dependent on the governance arrangements and Ofgem considers that with effective governance arrangements these costs should be avoidable.

## ***Benefits***

7.19. Ofgem has identified the following potential benefits associated with Option B:

- ◆ **Non discrimination in the Network Code modification process.** An independent Governance Entity would be responsible for administering

the change management processes associated with Network Code modification and transmission and distribution charges proposals. This approach may assist in delivering non-discriminatory treatment of Network Code modifications and, would, relative to Option A and the base case, be beneficial;

- ◆ **DCM governance fragmentation.** Option B reduces the potential for fragmentation of the administration of pricing methodology arrangements across networks as the Governance Entity would be able to ensure equality of treatment of modifications and alert the industry during the development of proposals before they are sent to the Authority for determination;
- ◆ **credit and cash collection.** Under Option B1, the fact that credit arrangements and cash collection are retained with the DN means there is greater accountability for credit arrangements with the respective DN owners. Conversely, the benefit of Option B2 would be that the fragmentation of payment channels and the associated costs to shippers associated with that approach would not be incurred, although Ofgem's assessment is that these costs are not significant;
- ◆ **retail & wholesale competition.** For reasons set out in Chapter 6, the creation of an agency that is responsible for SPA processes across the NTS and DNs is likely to have positive benefits in terms of promoting retail and wholesale competition;
- ◆ **competition in metering.** Consistent with the 'no agency' Option, there may be a positive marginal benefit from having metering outside of the scope of the agency arrangements; and
- ◆ **competition and accountability in connections.** Consistent with the 'no agency' Option, there are benefits both in terms of accountability and in competition, of not including connections within the scope of the Agent's activities.

## ***Evaluation of costs and benefits***

7.20. In Table 7.3, we present an assessment of the costs and benefits of Options B1 and B2.

**Table 7.3: Summary of costs and benefits of Option B1 and B2**

Issue	Assessment	
	Option B1	Option B2
<b>Accountability</b>		
♦ Credit and cash collection	✓✓	✗✗
♦ Settlement and operational systems	✓✓	✓✓
♦ Non competitive connections	✓	✓
<b>Cost mitigation</b>		
♦ Credit and cash collection	✗	✓
♦ Settlement and operational systems	✗	✗
♦ SPA systems	✓✓✓✓	✓✓✓✓
♦ DCM governance arrangements	✓	✓
<b>Non-discrimination in modification process</b>	✓	✓
<b>Competition</b>		
♦ Wholesale & retail	✓	✓
♦ Metering	✓	✓
♦ Connections	✓	✓
<b>Quality of service</b>	✓✓✓	✓✓✓

## ***Option C – Including AT-link and RGTA***

7.21. Option C is similar to the variant of Option B that does not include transmission and distribution charges cash collection and credit management (Option B1) within the Agency role. However, under Option C the AT-link and RGTA systems become the responsibility of the agency. For the avoidance of doubt, in this Section we are only discussing the operation of the IT systems and processes and are not discussing the Agent conducting Transco's system operation role. We present our assessment of the costs and benefits of this option in the following subsections:

### ***Costs***

7.22. The key potential costs associated with this approach over the Option B1 type approach are:



- ◆ **lack of accountability for operational data.** The fact that the Agent would be responsible for the provision of AT-link and RGTA and, therefore, the collection of operational data for use by Transco could blur the accountability for collection of that data. This is, potentially, significant given the operational nature of this data;
- ◆ **quality of service.** By having all systems centralised, it would not be possible to undertake comparative regulation of the activity. This may impact negatively on both the quality of service and the tendency for innovation in the provision of, for instance, the nominations systems and processes. Of course, it would be still possible to incentivise the Agent under an appropriate incentive scheme.

### ***Benefits***

- 7.23. The key benefit of this approach over and above the benefits of Option B1 is **cost mitigation**. Under this option, all of the gas settlement systems would be located within a single agency function. This would potentially have the benefit, from the perspective of the shipper, of preventing fragmentation of the settlement and operational systems in the long term. However, Ofgem considers that this benefit is potentially not significant as with appropriate governance arrangements, both through modifications to the Network Code and through the UK link committee that would be chaired by the Governance Entity, the risk of fragmentation could be efficiently managed.
- 7.24. Given that there are more activities within the scope of the agency under this option, relative to B1, the potential for **quality of service** improvements through comparative regulation and competition are reduced slightly. Of course, Ofgem would intend that the Agent would still be incentivised to deliver high levels of quality.

### ***Evaluation of costs and benefits***

- 7.25. In Table 7.4 below we present our assessment of the costs and benefits of this approach.

**Table 7.4: Summary of costs and benefits of Option C**

Issue	Assessment
<b>Accountability</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ Non competitive connections</li> </ul>	<ul style="list-style-type: none"> <li>✓✓</li> <li>✗</li> <li>✓</li> </ul>
<b>Cost mitigation</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ SPA systems</li> <li>◆ DCM governance arrangements</li> </ul>	<ul style="list-style-type: none"> <li>✗</li> <li>✓✓</li> <li>✓✓✓✓</li> <li>✓</li> </ul>
<b>Non-discrimination in modification process</b>	✓
<b>Competition</b> <ul style="list-style-type: none"> <li>◆ Wholesale &amp; retail</li> <li>◆ Metering</li> <li>◆ Connections</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> <li>✓</li> </ul>
<b>Quality of service</b>	✓✓

## ***Option D – Allocating systems with responsibilities***

7.26. This option is also similar to Option B1, but has the IT systems split so that:

- ◆ the operational systems currently associated with AT-link would be replaced by dedicated operational systems that reside with Transco as operator of the NTS and residual gas balancer. To the extent that DNs require operational data from shippers that are currently provided by the AT-link systems, they too would be provided by separate dedicated operation systems. The operational aspects of the RGTA system would also reside with Transco under this approach;
- ◆ the settlement systems currently associated with AT-link and RGTA would be replaced with dedicated settlement systems that would be under the control of the Agent as the central settlements agency.

7.27. Ofgem recognise that this may not be possible initially following Transco's proposed sale. However, it may be appropriate to develop this option over time, potentially for implementation by the next price control review.

7.28. We highlight our assessment of the costs and benefits of this option in the following subsections.

### ***Costs***

7.29. There are potentially significant costs associated with fragmentation of the current systems. These include:

- ◆ **AT-link and RGTA settlement systems fragmentation.** As explained in Chapter 2, the Gemini systems, currently being implemented by Transco, are intended to go live fully from Spring 2005 (although the entry capacity aspects of the system are likely to go live sooner). This will update the current AT-link and RGTA systems. To the extent that this option would require amended systems, this option might cause some redundancy in the Gemini systems and a requirement to replicate functionality in a new system and to create additional interface costs. These costs are likely to be in excess of £10m. It would be possible, of course, to protect customers from this cost by not allowing additional IT spend associated with this to be recovered through the price control;
- ◆ **shipper systems replacement of interface costs.** New central systems would also require potentially significant changes to shipper systems and interfaces with commensurate, potentially significant, costs; and
- ◆ **fragmentation of the nominations process.** Currently shippers provide nominations through AT-link. There is a risk, if each network owner were to require its own set of operational information, that shippers would need to provide operational data to each network owner, thereby increasing the costs to shippers.

### ***Benefits***

7.30. The benefit of this approach over and above those set out for Option C is that **accountability** for the systems that network owners and the settlement agent require respectively would be very clearly defined. Under this approach the network owners would be responsible for systems associated with operational data and the Agent would be responsible for all of the market's settlement systems.

## ***Evaluation of costs and benefits***

7.31. We provide a summary of the costs and benefits of Option D in Table 7.5 below.

**Table 7.5: Summary of costs and benefits of Option D**

Issue	Assessment
<b>Accountability</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ Non competitive connections</li> </ul>	<ul style="list-style-type: none"> <li>✓✓</li> <li>✓✓✓</li> <li>✓</li> </ul>
<b>Cost mitigation</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ SPA systems</li> <li>◆ DCM governance arrangements</li> </ul>	<ul style="list-style-type: none"> <li>×</li> <li>×××</li> <li>✓✓✓✓</li> <li>✓</li> </ul>
<b>Non-discrimination in modification process</b>	✓
<b>Competition</b> <ul style="list-style-type: none"> <li>◆ Wholesale &amp; retail</li> <li>◆ Metering</li> <li>◆ Connections</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> <li>✓</li> </ul>
<b>Quality of service</b>	✓✓✓

## ***Option E - including RGTA systems with the NTS and AT-link with the agency***

7.32. In developing Option D, Ofgem recognises that, whilst this Option may have advantages of ensuring that systems are allocated according to responsibilities, new systems would need to be developed to separate the operational and settlement activities of AT-link and RGTA. Ofgem additionally recognised that it might not be possible, due to systems constraints, to implement Option D in the timeframes of Transco's proposed sales. Ofgem recognises that the costs associated with this system development might be high, as shippers would have to develop systems to interface with both the NTS and DNs. Taking these costs into consideration, Ofgem has developed Option E, in which the NTS keeps responsibility for the RGTA systems while AT-link is placed in the agency. For the avoidance of doubt, in this Section we are only discussing the operation of

the IT systems and processes and are not discussing the Agent conducting Transco's system operation role.

- 7.33. We highlight our assessment of the costs and benefits of this option in the following Subsections.

### ***Costs***

- 7.34. The principal costs associated with this approach compared to Option B1 are:

- ◆ **costs of separating systems.** It is likely that there will be some costs associated with separating the RGTA from the AT-link system, particularly given the intended move to the Gemini system. It would be possible, of course, to protect customers from this cost by not allowing additional IT spend associated with this to be recovered through the price control;
- ◆ **reduced AT-link accountability.** The fact that the nominations data from shippers flows to the Agent when it is required by the network owners might reduce the accountability for this data flow; and
- ◆ **development of innovation in nominations systems and processes.** As with Option C, a centralised nominations system would mean it would not be possible to undertake comparative regulation of the activity. This might impact negatively on both the quality of service and the tendency for innovation in the provision of nominations systems and processes. Of course, it would be possible to incentivise the Agent under an appropriate incentive scheme.

### ***Benefits***

- 7.35. The benefits of this approach compared to Option B1 are:

- ◆ **accountability** for the NTS capacity systems would be clearly defined;
- ◆ **prevent fragmentation of settlement and nominations systems.** Establishing the AT-link systems with the Agent has two main benefits, namely that:

- ◆ the **settlement systems** would be retained within the Agent, thereby discouraging inefficient fragmentation of the settlement systems in the long-term. However, as noted earlier, Ofgem considers that preventing inefficient fragmentation can be achieved through effective governance arrangements; and
- ◆ **reduced operational interfaces.** Nominations data would be received by a single entity, thereby reducing the number of interfaces for a shipper.

### ***Evaluation of costs and benefits***

7.36. We provide a summary of the costs and benefits of Option E in Table 7.5 below.

**Table 7.6: Summary of costs and benefits of Option E**

Issue	Assessment
<b>Accountability</b>	
◆ Credit and cash collection	✓✓
◆ Settlement and operational systems	✓
◆ Non competitive connections	✓
<b>Cost mitigation</b>	
◆ Credit and cash collection	✗
◆ Settlement and operational systems	✓
◆ SPA systems	✓✓✓✓
◆ DCM governance arrangements	✓
<b>Non discrimination in modification process</b>	✓
<b>Competition</b>	
◆ Wholesale & retail	✓
◆ Metering	✓
◆ Connections	✓
<b>Quality of service</b>	✓✓

### ***Option F – Broadest agency***

7.37. Option F sets out the broadest possible role of the Agent. As well as the services carried out by the Agent (and Governance Entity) under Option C, the Agent would also perform credit management and revenue collection, and acts as a single point of contact for shipper and suppliers in relation to metering and connections.

7.38. We set out in the following subsections, Ofgem's assessment of the cost and benefits of this option.

### **Costs**

7.39. Ofgem has identified the following potential costs associated with Option F:

- ◆ **Accountability for credit and cash collection.** Under Option F, the Agent manages the credit on behalf of each network operator. This could result in a less efficient set of credit arrangements since the Agent does not bear the risk associated with poor credit management processes;
- ◆ **systems accountability.** There could be a lack of accountability associated with the provision of the AT-link and RGTA systems were the Agent to be responsible;
- ◆ **competition in metering.** Under Option F, the Agent is a single point of contact for shippers and suppliers in relation to metering. This is likely to have a negative impact on competition, as it would perpetuate the competitive advantage of incumbent DN service providers, as shippers and suppliers are not encouraged to consider using alternative service providers;
- ◆ **competition and accountability in connections.** Option F would potentially inhibit further development in competition in connection as the agent would become the single point of contact for all new connections. This risks hindering the development of competition as the DNs, when notified by the Agent, might be more inclined to use existing service provider contracts and therefore reduce the likelihood of new entrants into the competitive areas of the market. Furthermore, it may make accountability for delivery of the connections responsibility more blurred as the point of contact would be the Agent rather than the DN responsible for delivery; and
- ◆ **quality of service.** Under this approach, the fact that a large range of activities are under the remit of the Agent limits the potential for competitive provision or provision of the service in an environment of

comparative regulation. In turn, this could impact on the quality of service and the tendency for innovation in provision. Of course, the Agent would be still be subject to incentives.

### ***Benefits***

7.40. Ofgem has identified the following potential benefits associated with Option F:

- ◆ **non discrimination.** Option F, as with Option B, establishes an independent Governance Entity with responsibility for administering the change management processes associated with Network Code modification proposals. It would be required to carry out its functions in a non-discriminatory manner;
- ◆ **fragmentation.** More than any other option, Option F limits opportunities for fragmentation. A Governance Entity would administer changes to the Network Code and charging methodologies. Similarly, the Agent would manage the credit arrangements of all network operators and also undertakes the provision of the RGTA and AT-link systems; and
- ◆ **retail & wholesale competition.** For reasons set out in Chapter 6, the creation of an agency and a single body that is responsible for SPA processes across the NTS and DNs is likely to have positive benefits in terms of promoting retail and wholesale competition.

### ***Evaluation of costs and benefits***

7.41. We set out in Table 7.7 our overall evaluation of the costs and benefits of Option F.



**Table 7.7: Summary of costs and benefits of Option F**

Issue	Assessment
<b>Accountability</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ Non competitive connections</li> </ul>	<ul style="list-style-type: none"> <li>✗ ✗</li> <li>✗</li> <li>✗</li> </ul>
<b>Fragmentation</b> <ul style="list-style-type: none"> <li>◆ Credit and cash collection</li> <li>◆ Settlement and operational systems</li> <li>◆ SPA systems</li> <li>◆ DCM governance arrangements</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓ ✓</li> <li>✓ ✓ ✓ ✓</li> <li>✓</li> </ul>
<b>Non discrimination in modification process</b>	✓
<b>Competition</b> <ul style="list-style-type: none"> <li>◆ Wholesale &amp; retail</li> <li>◆ Metering</li> <li>◆ Connections</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✗</li> <li>✗</li> </ul>
<b>Quality of service</b>	✓

## 8. Conclusion

8.1. In this Chapter, we set out:

- ◆ a summary of Ofgem's qualitative assessment of the cost and benefits of each option;
- ◆ an index that illustrates the relative magnitude of cost savings over the 'no agency' Option for shippers. This analysis has been indexed to preserve the anonymity of the confidential shipper responses to the questionnaire issued by Ofgem to sample of shippers; and
- ◆ Ofgem's initial recommendations and invite respondents' views on these.

### ***Qualitative assessment summary***

8.2. In Table 8.1 we summarise Ofgem's qualitative assessment of the cost and benefits of each option for the structure of the agency.

8.3. The main points to note from Table 8.1 are:

- ◆ all agency options deliver significant benefits over the 'no agency' Option;
- ◆ the greater the scope of the Agent's role, the larger the potential for cost mitigation as the risk of fragmentation would be reduced. However, even under a more shallow role for the agent, Ofgem considers that it would be able to ensure cost mitigation through effective governance arrangements;
- ◆ the greater the scope of the Agent's role, there is an increasing risk that the accountability for delivery of the services is diminished. There might also be costs associated with reduced levels of quality of service (although these could be mitigated by appropriate incentive based regulation);

- ◆ the creation of a governance entity mitigates the risk that Transco NTS could discriminate against IDNs in the modification process;
- ◆ the creation of the agency delivers significant benefits for wholesale and retail competition relative to the 'no agency' Option; and
- ◆ metering and connections competition would be, at the margins, be enhanced by retaining the customer interface for the provision of connection and meter providers of last resort directly with the respective network owners.

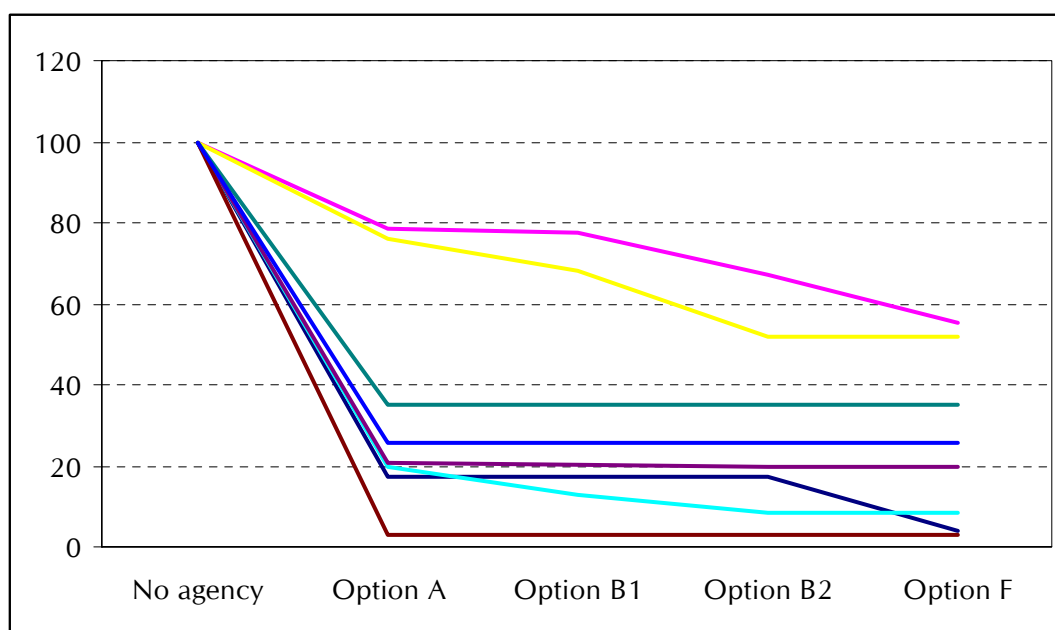
**Table 8.1: Summary of evaluation of cost and benefits of options**

		Option A	Option B1	Option B2	Option C	Option D	Option E	Option F
	No Agent	NGT's initial proposal	Introducing governance entity	B1 plus credit arrangements with Agent	AT-link plus RGTA	Splitting systems with responsibilities	RGTA with NTS & AT link with Agent	Broadest Agent
<b>Accountability</b>								
♦ Credit and cash collection	✓✓	✓✓	✓✓	✗✗	✓✓	✓✓	✓✓	✗✗
♦ Settlement and ops systems	✓✓✓✓	✓✓	✓✓	✓✓	✗	✓✓✓	✓	✗
♦ Connections	✓	✓	✓	✓	✓	✓	✓	✗
<b>Cost mitigation</b>								
♦ Credit and cash collection	✗	✗	✗	✓	✗	✗	✗	✓
♦ Settlement and ops systems	✗✗✗	✗	✗	✗	✓✓	✗✗✗	✓	✓✓
♦ SPA systems	✗✗✗✗	✓✓✓✓	✓✓✓✓	✓✓✓✓	✓✓✓✓	✓✓✓✓	✓✓✓✓	✓✓✓✓
♦ DCM governance arrangements	✗	✗	✓	✓	✓	✓	✓	✓
<b>Non – discrimination in modifications process</b>	✗	✗	✓	✓	✓	✓	✓	✓
<b>Competition</b>								
♦ Wholesale & retail	✗✗✗	✓	✓	✓	✓	✓	✓	✓
♦ Metering	✓	✓	✓	✓	✓	✓	✓	✗
♦ Connections	✓	✓	✓	✓	✓	✓	✓	✗
<b>Quality of service</b>	✓✓✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓

## *Index of shipper costs*

- 8.4. To gain a greater understanding of the costs of the various options, Ofgem conducted a survey of market participants. The pro forma that was sent to market participants is attached in Appendix 1.
- 8.5. Figure 9 sets out each shipper's costs relative to its assessment of the 'no agency' base case Option.

**Figure 9: Index of shipper assessment of costs of DN Sales relative to base case of no Agent**



- 8.6. This highlights that:
- ◆ there are significant cost savings with the creation of an agency;
  - ◆ only a few shippers perceive that there are any material costs associated with the DNs undertaking cash collection and credit management for its own business (i.e. between Option B1 and B2); and
  - ◆ some shippers noted significant cost savings when the role of the Agent was as broad as possible; others, conversely, did not report any material costs over other options.

## ***Ofgem initial recommendations and the way forward***

8.7. Ofgem believes that the establishment of the Agent is essential to mitigate the potential costs that customers could incur were the sale of DNs to proceed. Based on the assessment in this document, Ofgem's initial view is that two agency options have significant merits over the other approaches considered. They are:

- ◆ **Option B1.** This offers significant benefits over and above Transco's initial proposals through the establishment of the Governance Entity, whilst preserving appropriate levels of accountability with respective network owners; and
- ◆ **Option E:** This approach has additional benefit of placing all the shared settlement systems within the agency, similar to the approach in the electricity market. The RGTA systems would remain with the NTS to ensure an appropriate degree of accountability for delivery of this service.

8.8. Ofgem invites views on these and all the other options considered in these document. Respondents' are invited to provide Ofgem their views on the costs and benefits associated with their preferred option. Ofgem welcomes views on this RIA, to be received by close of business 17 May 2004. Respondents are requested to provide views in a timely manner.

8.9. Ofgem hopes to reach a decision on Agency and governance arrangements by the end of May 2004, although this will depend on whether any new and material information is received from respondents which results in Ofgem having to carry out further analysis.



# Appendix 1 Cost benefit analysis assumptions and methodology

- 1.1 This appendix sets out the assumptions and methodology used to derive the quantitative estimates of costs and benefits associated with each of the options for the role of the Agent
- 1.2 In order to help Ofgem understand the potential costs to be incurred by the shippers/suppliers under the various options for governance and agency arrangements, Ofgem issued a confidential pro-forma document for completion by shippers on 19 March 2004. (The pro-forma and covering letter are contained in this appendix.)
- 1.3 The pro-forma set out a detailed list of the possible functions and services that are currently provided by Transco and DNs and which could be adopted by an agency or governance body. The list of services was developed in consultation with the workgroups.
- 1.4 The purpose of the pro-forma was to enable shippers and suppliers to provide information on:
  - ◆ the impact of DN sales on the costs (both one-off and ongoing) to shippers and suppliers associated with the provision of the various functions and services currently provided by the NTS and DNs;
  - ◆ the one-off and ongoing cost impact on shippers and suppliers, were these services to be provided by a central agency body. This impact could be positive to the extent that the establishment of an agency body mitigates the costs of DN sales.
- 1.5 The pro-forma was sent to 11 shippers and suppliers, and Ofgem received 8 responses.
- 1.6 As the pro-forma contains information that is commercially sensitive, Ofgem is unable to report the results in a way that would enable any confidential information to be attributed to any particular party.



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19 March 2004

Dear Colleague,

**Detailed pro-forma on the cost impacts of DN sales**

Earlier this month Ofgem announced that in considering National Grid Transco's proposals to sell one or more gas distribution networks (DNs) it would issue two Regulatory Impact Assessments.

These RIAs relate to:

- the development of appropriate governance and agency arrangements for shipper/customer interfaces with Transco's NTS and the DNs; and
- the allocation of roles and responsibilities as between Transco, as owner of the National Transmission System and each of the DNs.

Ofgem intends to issue its consultation on these RIAs following the April meeting of the Authority. The RIAs will be issued if the Authority takes the decision that it is appropriate for work to continue on the DN sales project. Subject to the Authority decision, we are intending to issue this RIA for consultation on the week commencing 19 April 2004.

In preparing the proposed RIA on agency and governance arrangements it is necessary to consider the cost impacts of DN sales on many of the services currently provided by Transco and DNs and to understand the impact of the creation of an agency on these costs. It is intended that the results of this RIA would feed into the broader cost and benefit analysis being undertaken by Ofgem with respect to DN sales.

At this stage, the industry workgroups that have been established as part of the DN sales consultation process have been discussing a number of options for the development of an agency and governance framework. These options have ranged from a 'narrow' agency concept which is responsible for a limited range of functions including supply point administration, to a 'broad' agency concept which would include other roles such as Network Code and charging methodology governance processes.

In order to assist Ofgem in understanding the costs likely to be incurred by the shippers/suppliers in assessing the various options for governance and agency

arrangements, we have prepared the attached pro-forma document for completion by shippers.

The pro-forma sets out a detailed list of the possible functions and services that are currently provided by Transco and DNs and which could be adopted by a central agency or governance body. The services that are listed have been developed in consultation with the workgroups.

The purpose of the pro-forma is to enable shippers and suppliers to provide information on:

- the impact of DN sales on the costs (both one-off and ongoing) to shippers and suppliers associated with the provision of the various functions and services currently provided by the NTS and DNs;
- the one-off and ongoing cost impact on shippers and suppliers, were these services to be provided by a central agency body. This impact could be positive to the extent that the establishment of an agency body mitigates the costs of DN sales.

We would be grateful if you could return your response to the attached pro-forma by close of business Friday 26 March 2004. Please be assured that all responses will be treated as confidential.

If you have any questions regarding this request please contact me on the above number or alternatively Mark Feather on extension 7437 or Jason Mann on 7165.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Sonia' followed by a stylized surname.

Sonia Brown  
Director, Transportation

NGT base case	High level function	Detailed function	Process	System	Obligations / Governance	No Agency		With Agency	
						one off cost to your business (£000s)	on going cost to your business (£000s/pa)	one off cost to your business (£000)	on going cost to your business (£000/pa)
Agent			Calculation of metered volume and quantity	SPA Application/S&M Database	Network code				
Agent			Submission of valid meter readings to users	Shipper interface via IX; from SPA Application, from S&M Database	Network code				
Agent		AQ & SOQ Reviews	Determination of the annual quantity for the gas year by supply meter point	Shipper interface is via IX	Network code				
Agent			Determination of the annual quantity for the gas year by sub group (aggregation)	Shipper interface is via IX	Network code				
Agent			Confirmation AQ (responding to capacity revision applications from users)	IX	Network code				
Agent			Amendments to AQ (new or revised supply point capacity or supply point offtake rate)	IX	Network code				
Agent	Transportation invoices and credit arrangements				Network code				
Agent		Invoicing	NTS capacity	Billing 2000 & invoicing 95	Network code				
Agent			Exit Capacity (DN)	Shipper interface is via IX; from Invoicing 95	Network Code				
Agent			Commodity	Shipper interface is via IX; from Invoicing 95	Network Code				
Agent			Reconciliation	Shipper interface is via IX; from Invoicing 95	Network Code				
Agent			Adhoc invoice & backup information	Shipper interface is via IX;	Network code & Guidelines				

NGT base case	High level function	Detailed function	Process	System	Obligations / Governance	No Agency		With Agency	
						one off cost to your business (£000s)	on going cost to your business (£000s/pa)	one off cost to your business (£000)	on going cost to your business (£000/pa)
Agent			Adjustments (Energy & Transportation)	Shipper interface is via IX;	Network code				
Agent			Billing data management - Query services	Shipper interface is via ConQuest; through to Billing2K	Network Code				
Agent		Credit management	Submit Invoice	IX	Network Code				
Agent			Credit reports		Network Code				
Agent			Record user's credit limit		Network Code				
Agent			Calculation of user's outstanding balancing indebtedness		Network Code				
Agent			Submission of cash calls		Network Code				
Agent			Enforcement and recovery		Network Code				
Agent	Other				Network code				
Agent		User admission and termination	Issue relevant notices following admission of an applicant user						
Agent			Termination of discontinuing user	IX	Network code				
Agent			Termination of defaulting user	IX	Network code				
Agent		Connected system exit points	Validation of relevant data	CSEPs	NExA				
Agent		NExA supply meter points	Notification of existence of NExA						
Agent			Notification to reduce gas supply at NExA supply meter point						
Agent		Must read	Notification of failure of a user to obtain and provide valid meter readings for non daily read meters		Network code				
Agent		Generation of meter point reference number	Generation of meter point reference number for a new supply meter point	Sites & Meter database					
Agent	Supply point information services				Transportation license				
Agent		Maintain supply point information service to specified persons							
Agent		M number bureau (customer helpline)	Provision of relevant data to customers	Consumer interface via call centre	Licence				

NGT base case	High level function	Detailed function	Process	System	Obligations / Governance	No Agency		With Agency	
						one off cost to your business (£000s)	on going cost to your business (£000s/pa)	one off cost to your business (£000)	on going cost to your business (£000/pa)
Agent		M number bureau and web site (shipper helpline)	Provision of relevant data to shippers	Shipper interface via call centre	Licence				
Agent		Request for Information RFI Bureau	Provision of data in relation to premises occupied by customer	Shipper interface via call centre (RFI Bureau)	Licence				
Agent		Meter inspection	Notification to users where no meter inspection has occurred for 2 years		Network Code				
Agent		Connection & Disconnection Notice	Receipt and notification of proposed C&D of meter to a service pipe	C&D store +IX	Network Code				
Agent		Gas shrinkage	Theft of gas						
Agent			Gas used for operational purpose (not an Agency Function)*						
Agent			Gas lost through leakage (not an Agency function)*	*the result of these activities may involve use of data from agency or the revision of transportation charges					
Agent			billed/actual calorific value variation) (not an Agency function)*						
Agent		Provision of information to Ofgem			Licence				
Agent	Other services				Transportation license				
Agent		Provision of information to support customer complaint resolution			Licence				
Agent		Provision of reports submitted to users	Shipper portfolio statement, shadow log report, portfolio extracts		Operational practice				
Agent		Provision of account receivable information							

						No Agency		With Agency	
NGT base case	High level function	Detailed function	Process	System	Obligations / Governance	one off cost to your business (£000s)	on going cost to your business (£000s/pa)	one off cost to your business (£000)	on going cost to your business (£000/pa)
Agent		Calculation and notification of liability payments			Network Code				
Agent		Service provider's business processes	Billing Ops and billing data forums		Operational practice				
Agent		Regulatory consultation analysis	This would be provided to support DNs in the PCR process but is not a Shipper service)						
Agent		UK Link services	Change in UK Link file format		UK link manual / UK Link Committee				
NTS	Network code governance		Modification rules (administration)		Network code				
NTS	On line network code	Where short form codes exist what is the scope of the Agent role							
NTS	Transmission charges credit and cash collection								
NTS	Transmission charging methodology								
NTS	NTS capacity auction and trading		Facilitate bid submission and confirm acceptance		Offtake agreement				
NTS			Capacity management						
NTS			Provision of entry capacity						
NTS			Purchase of long term entry capacity						
DN	Distribution charging methodology		Secretarial service for change management (only)						
DN	Distribution charges credit and cash collection								
DN	Network safety/emergency								
DN			Disconnection process						
DN			Reconnection process						
DN			DN safety case		HSE				

						No Agency		With Agency	
NGT base case	High level function	Detailed function	Process	System	Obligations / Governance	one off cost to your business (£000s)	on going cost to your business (£000s/pa)	one off cost to your business (£000)	on going cost to your business (£000/pa)
DN			Management of safety jobs		Gas Safety Management Regulations GSMR				
DN	Demand estimation		Demand estimation report						
DN	Connections								
DN	Metering								
DN			Ownership of metering assets						
DN			Data ownership and transfer (requirement to provide metering information)						
DN			Maintenance of metering assers						
DN			Metering of last resort						
DN	Site works								
DN			Customer sitework requirement						
DN			Supply company sitework requirement						
DN			Sitework reporting						
DN			Sitework notification						
DN	Customer and consumer relations		Customer satisfaction reports						

# Appendix 2 : NGT's Gemini system

## DN Disposals Programme Ofgem Agency RIA

### APPENDIX 2 – The GEMINI System

#### The requirement for shipper facing IT systems

An essential requirement of the introduction of the Network Code in March 1996 was the development of IT systems and interfaces to support the commercial regime.

The Network Code references the UK-Link suite of systems that support the shipper-transporter interface. The UK-Link system was one of the biggest systems projects undertaken and comprised the development of databases and associated structures necessary to administer, operate and bill for services associated third party access to transportation services in respect of more than 20 million supply points.

A key component of the original UK-Link suite was the AT-link system.

In order to balance the gas transportation system, Transco needs to know how much gas will flow into and out of the National Transmission System on a daily basis. The AT-link system is used by both UK Link Users and Transco plc who access the system directly via terminal emulation approaches.

The main functions provided by AT-link were:

- service registration (including NTS entry and exit capacity booking)
- capacity trading
- storage inventory monitoring
- gas flow nominations (and renominations)
- scheduling
- NBP gas trade registration
- the provision of the Flexibility Mechanism
- the capture of measurement data
- allocations (including NDM attribution and receipt of data from CVA)
- balancing.

The transactions carried out on-line are recorded onto the AT-link database.

The system then provided data into the Invoicing '95 system where all invoicing and credit billing activities were conducted. This encompassed both energy balancing related activities (the "settlement function") associated with scheduling charges, flexibility mechanism payments and receipts, shipper imbalance cashout payments and receipts and the redistributions associated with the daily neutrality processes. Additionally AT-link provided a key input to enable the Invoicing '95 system to derive and then bill NTS transportation charges (NTS Entry and Exit capacity and NTS commodity charges) as well as contributing to the invoicing of LDZ transportation capacity and commodity charges.



The AT-link system therefore provided essential information in respect of before the day (eg capacity booking , nomination, scheduling) and within day (eg renominations and flexibility mechanism) shipper activities and possible gas flows to support Transco's operational decision making processes to enable efficient system operation. The data then captured both before and during the day (eg nominations) and after the day (eg measurements) then feed subsequent transportation billing and energy balancing settlement functions.

### **The Reform of Gas Trading Arrangements October 1999**

These reforms introduced two major changes; the On the Day Commodity Market (OCM) and the introduction of NTS entry capacity auctions.

These required two major changes in respect of the system functionality that had previously been delivered by AT-link.

The OCM replaced the flexibility mechanism as Transco's primary system balancing tool. The introduction of the OCM involved

- the disabling of the flexibility mechanism, but with an ability to reinstate to satisfy operational requirements as a contingency against OCM failure
- the implementation of new interfaces to the OCM to accommodate the necessary transfer of NBP trade information and the associated information essential to Transco's residual system balancer role, associated with physical and locational OCM transactions.

Having regard to the feasibility, costs, risks and timescales associated with delivering the requirements Transco elected to make changes to the AT-link system to facilitate the introduction of the OCM.

The NTS entry capacity changes involved the replacement of the on-demand administered release of entry capacity by sale via auction processes. Given the fundamental change in processes required, the feasibility of accommodating such change in the AT-link system and the very limited time available to implement NTS entry capacity auctions it was decided that a new system would be necessary hence the development of the RGTA Capacity System.

In order to flow gas into the NTS users are expected to obtain system entry capacity. The RGTA Capacity System is used by both UK Link Users and Transco for this process.

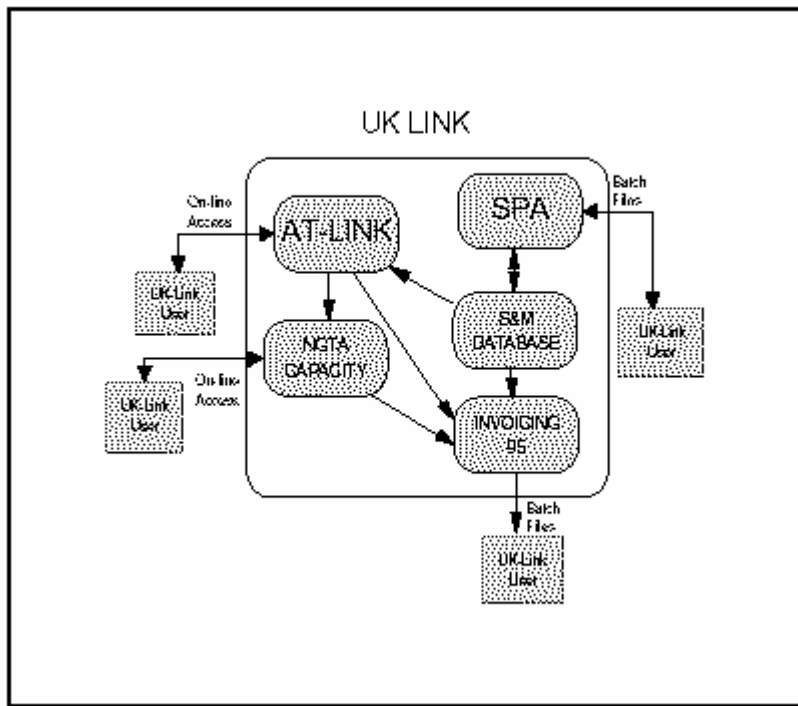
Additionally the RGTA capacity system currently provides the following key functionality:

- all entry capacity auctions (including all quarterly, monthly, and daily capacity release (both firm and interruptible) )
- the "buy back" of capacity for capacity management purposes
- the registration of NTS entry capacity trades

- the provision of data to Invoicing '95 to support the invoicing of NTS entry capacity and overruns.

The system therefore provides an essential tool to ensure the operational management of the NTS.

The current UK-Link system and configuration is illustrated in the following diagram:



Since the Reform of Gas Trading Arrangements Network Code changes have continued and hence it has been decided that in the interests of efficiency and robustness it is essential that both the AT-link system and the RGTA system are replaced.

The replacement affords the opportunity to update the technological base on which AT-link is based (which many consider to be outdated mainframe technology) and for the RGTA system (which has proved expensive to evolve and update given the extensive entry capacity regime changes that have occurred since RGTA) to develop a new system, database structures and user interface. This should more efficiently accommodate changed requirements going forward.

The requirement necessitated a significant systems project named Gemini designed to realise the efficiencies associated with a re-write of both systems and the scope to integrate the systems to deliver common “look and feel” and interfaces.

### Current Gemini Position

This project is already at an advanced stage having been running for in excess of 2 years. The capacity component of the system is in the final testing phases consistent with a July 2004 implementation. The AT-link replacement functionality has already been built. However the complexity of the processes and code is such that testing and implementation of this part of the system will complete early next year. The full Gemini system is therefore scheduled for live operation starting in the spring of 2005.

The phased implementation has been developed to manage the risks associated with the Gemini programme taking account of the replacement of Transco's current operational control and scada systems (the iGMS programme) and the associated interface issues.

## **Appendix 3 : Xoserve**

- 3.1 The attached press release, dated 5 April 2004, provides details of NGT's public announcement of the launch of Xoserve.



I am writing to tell you about the today's launch of xoserve as a separate internal business within National Grid Transco. This is a significant milestone on the road to creating an independent data management and commercial services company.

Known up to now under the working title of 'Agency', xoserve initially is comprised of the parts of NGT that interact with or provide services to gas shippers. These are Billing Data Management, Billing Operations, Business Projects, Credit Risk Management Energy along with internal support functions. Over time, as the consultation process on network sales proceeds, the scope of the Agency may well change.

The impetus for setting up xoserve comes from the proposal to sell one or more networks. The agency model is being recommended as the best option for minimising impacts on Shippers and the gas transportation commercial regime in relation to potential network sales. In this model xoserve will provide the transactional services that NGT provides at the moment. The most important of these are supply point services, billing services, energy balancing, data management and information services.

The aim is for xoserve to eventually become fully separated from NGT as one of the changes necessary to underpin potential network sales. However, if no networks are sold it will still become a separate internal business. Separation and removal of its services from the regulated business means it may be able to offer new unregulated commercial services to the wider industry.

xoserve will act as the interface between gas distribution networks, whoever owns them (and at this stage NGT could still continue to own all the networks) and the shipping community. As a key contact point xoserve will ensure consistent processes across all networks, ensuring shippers won't need to implement costly system changes if any networks are sold. It will continue to interface with Gas Transmission as it does now.

The initial arrangement of xoserve as a separate business within NGT allows the industry to observe and experience the new agent operating model in advance of the formal separation of any Distribution Network. This will confirm that you will see no adverse changes to your operational processes and systems.

xoserve will continue to be based in Solihull in the West Midlands and is taking over the lease on the building it currently occupies at 51 Homer Road.

"Whilst a challenging future lies ahead as we develop the infrastructure of the business, I believe we have a strong team of people with the right skills and culture to make this independent company a success.

The new xoserve Management Team reporting to me will be: -

**Steve Coomber - Finance Manager** responsible for all the financial aspects of xoserve in terms of accounting, funding and shareholder interfaces.

**Kim Salmon - Commercial Manager** responsible for the contractual interfaces and relationships with all external parties that have a service with xoserve or are part of the gas transportation community. This role is also responsible for the business development processes in xoserve.

**Clive Nicholas - Operations Manager** responsible for the day to day running of the xoserve processes whether mature or implementing changes for new services. Will continue strong focus on performance and quality.

**Paul Hastings - IS & Business Support Manager** responsible for all the IS service provision that underpins xoserve operations and all support functions.

I will provide further information as the need arises, however, if you have any queries, please let me know.

Ed Bannock

Chief Executive Officer

