

UNC GOVERNANCE – THOUGHTS AND ISSUES

1. BACKGROUND

At present Transco is responsible for the network code and the modification rules – in particular it has Licence obligations to establish and implement both the code and the modification rules. The cost of the modification process and implementation of modifications are included within its price controls. Ultimately Transco is responsible to ensure modification proposals make it through the process (under the mod rules it can take steps for this purpose if the Panel fail to do so).

The network code covers (in addition to SPA and the commercial regime for energy balancing) Transco's own rules for transportation, billing, credit and shipper obligations related to safety and efficient operation of the system.

Transco (and any subsequent DN GTs) has a significant interest (given its statutory, Licence and GSMR obligations) to ensure that the network code is properly drafted and workable.

Many network code issues are effectively polarised between Transco and shippers (Ofgem holds the ultimate decision in terms of balance given its role in the modification process). There is no equivalent uniform polarisation in the electricity balancing and settlement arrangements; this factor makes it possible for Elexon to undertake its role in relation to BSC.

Transco has responsibility for implementing modifications in terms of process, rule and systems changes. This gives it a further vital interest in ensuring that modifications are managed timely. Detailed aspects of consistency (internal within code and with other documents/systems etc) require Transco input, which cannot be effectively replicated within an independent organisation.

Areas where shippers (or suppliers) could arguably have a greater role are bundled in network code but are structurally disaggregated in electricity, which facilitates a number of solutions to the way governance is managed. In future SPA, metering and potentially the commercial settlement elements of energy balancing could be removed from the scope of network code and be given appropriate governance and modification processes that Transco has no reason to own. What would thus remain are the core areas of Transco's (GTs) business for which (as with CUSC and Grid Code) Transco (GTs) should be responsible for governance consistent with their Licence obligations.

2. NGT CONCERNS AND ISSUES

Transco/GTs should remain in control of the process if they are to be subject to comparable Licence conditions placing obligations on them. Any governance option in which they do not have such control/influence cannot be accompanied by such Licence conditions.

UNC GOVERNANCE – THOUGHTS AND ISSUES

Transco/GTs should also retain control of the modification process if the costs of the process are part of their price controls.

The core subject areas of network code mentioned above go to the heart of the way in which Transco/GTs undertake the commercial and physical operation of the system. Additionally recovery of allowed revenues is principally through the contractual arrangements that GTs are required to establish by their Licence. Transco/GTs therefore have the greatest interest in making sure that the contract is properly drafted and workable, no other organisation can be expected to take the same approach. If governance was removed from Transco/GTs it would be entirely reasonable to expect them to submit separate detailed representations to Ofgem for consideration at the time any modification report was made.

In practical terms within Transco the real knowledge on rules, processes and system is within the organisation. Given Transco's role in terms of implementation of modifications the same people would be required to ensure to undertake the content aspects of underlying work to allow modifications to be considered and implemented. Any independent organisation though would also need to replicate such individuals if it were to perform any content related role.

3. CONCERNS RAISED BY SHIPPERS

As Ofgem is aware, the modification rules have themselves become the subject of a modification proposal and consequently the governance arrangements of the Network Code have recently undergone one of the most intense period of scrutiny in their history since their inception in 1996.

During that review it is evident that shippers have some concerns regarding the operation of the rules although as part of these debates it has been stated by shippers that, in general, Transco's custodianship of process has generally met with their expectations. This is borne out by the level of customer satisfaction recorded against this activity.

Nevertheless a proposal to include the rules in the Network Code was submitted during Q4 2003. In its most basic form, the advantage of this would be to give shippers the opportunity to propose changes to the rules, and the inclination and intention to do so was indicated in the original proposal submitted.

For instance, one of the concerns raised is that Transco has "the last say" with the final mod report but in the licence it is required to "give the particulars of representations". Also Transco is required to give its opinion regarding implementation. Simple rule changes would not always resolve the issue but with the rules in the code, Ofgem would be required to rule on changes to the rules on the basis of furthering the relevant objectives. Also on this matter, despite Transco's perceived advantage in this respect no significant commercial advantage could be gained in preparing a report given that the representations used to draft the final report are sent to Ofgem along with it.

UNC GOVERNANCE – THOUGHTS AND ISSUES

In view of identified areas for debate, Transco would suggest some changes to the current form of governance to address these concerns which could include:

- a) Making amendments to the Panel voting structure to remove the requirement for Transco to support the progress of proposals to consultation.
- b) Potentially extending the role of the Panel beyond mere process which could include a role in signing off the final mod report submitted to Ofgem although Transco considers that it is still appropriate for the GTs to have the ability to make a recommendation given the impact of any modification upon the relevant objectives that the GT is required to meet. (This may well be required in any event in order to facilitate the requirements of the recent amendment to the Utilities Act, re requirement for a panel view in the appeals process.)

Regarding the list of issues included in the proposal, the majority are procedural and could be resolved with changes to Modification rules under the existing licensing arrangement. With respect to shippers proposing changes to the rules; the licences does not preclude them from doing so. Interestingly, neither the proposal nor any of the many shipper representations suggested that shipper concerns would be resolve by the introduction of third party administration.

In summary, Transco is of the opinion that shippers believe that fundamentally the process administration is sound but accept it could benefit from some procedural amendments.

4. ISSUES/CONCERNS AND OPTIONS FOR MULTIPLE TRANSCO/GT GOVERNANCE

If Ofgem (as it has previously indicated) accepts that a UNC whether or not short form network codes are adopted is an appropriate method to address the approach to transportation arrangements in a multi gas transporter environment as a result of network disposals, then UNC governance is an issue that will need to be addressed.

Transco has previously discussed both with Ofgem and with the RAWG the current Licence condition that deals with network code and that the modification rules will need to change. Transco assumes that the requirement in relation to one or more of the GTs will be based on an objective related to the co-ordinated and efficient operation of transportation arrangements in respect of the NTS and the distribution networks currently owned and operated by Transco. Transco also considers that the relevant current condition, which makes the GT responsible for its code and modification rules should be retained in relation to the UNC as this has a proven track record of

UNC GOVERNANCE – THOUGHTS AND ISSUES

securing the objective of having arrangements delivered within a reasonable time frame.

With this in mind, and as outlined in relation to the above Transco concerns, Transco considers that control of the governance should sit with the GTs and not with an independent organisation. There are a number of potential ways in which this could be structured which include:

- a) Having NTS as owner of the UNC.
 - i) Clearly such a suggestion is also linked with the discussion in relation to legal separation however it might be seen as a workable solution because it would include a single Licensee. From an Ofgem perspective in terms of effect, enforcement price controls etc there would be no ambiguity about responsibilities.
 - ii) NGT already anticipates a variety of additional licence conditions dealing with separation, ring fencing to prevent discrimination between retained and disposed DNs, such an approach would build on and complement such conditions.
 - iii) Such an approach would involve an additional Licence condition on Transco (NTS) to own the UNC in a governance sense and to establish modification rules. The modification rules could establish separate detailed rules in respect of DN related modifications which could provide for additional representations if there were for instance discrimination concerns about a particular proposal.
- b) UNC and modification process collectively owned by NTS and all DN owners.

The high level basis of this option for UNC governance would be that the UNC GTs have joint ownership of the UNC and therefore agree jointly to create an organisation (unincorporated) with the express purpose of managing the administrative functions of the UNC.

Each of the GT licence conditions would include an identical licence condition setting a shared common relevant objective i.e. the coordinated economic efficient operation of the System (i.e. NTS and DNs) and requiring them collectively to:

- Establish a UNC
- Establish and implement UNC modification rules.

The licence condition could then go on to require each GT to agree to cooperate jointly in relation to a number of issues with other licence holders to:

1. Establish the UNC;
2. Establish and operate modification rules;

UNC GOVERNANCE – THOUGHTS AND ISSUES

3. Utilise a joint agent to discharge certain UNC obligations on their collective behalf;
4. Administer transportation charging methodologies utilising the same process;
5. Operate a common set of UNC Code credit rules;
6. Provide common systems to undertake the data processing and transactional functions within UNC (i.e. UK Link);

The UNC GTs would discharge this requirement through a joint operating agreement that establishes the governance entity as an unincorporated organisation. Principal functions of this entity would be:

1. Act as a joint secretariat function to administer the modification process of UNC to include implementation of modifications;
2. Undertake the functions that such a licence condition requires them to achieve;
3. Instruct, where relevant, the Agency particularly with regard to the implementation of modifications that have been approved by Ofgem, and potentially acting as Network Operators representative in the context of the Agency Services Agreement;
4. Running the administrative process associated with the transportation charging methodologies of UNC GTs.

The Agreement would also need to provide for the basis on which the following aspects of the Governance Entity were carried out:

1. Setting out detailed secretariat functions;
2. establishing the governance structure of the Governance Entity (board composition, voting etc);
3. Funding;
4. Resourcing with appropriate persons;
5. reallocating costs from individual GT price controls ?;
6. providing necessary authorities to act jointly on behalf of UNC GTs eg. with Agency, or in respect of implementation of modifications;
7. provision for variation/additional scope;
8. establishing 'Chinese wall' arrangements?

It is also anticipated that NGT would also have within its GT licence an additional licence condition addressing concerns with regard to undue discrimination between DN licence holders.

This structure has a number of benefits from a regulatory perspective:

1. Licence obligations in respect of transportation arrangements can remain with the UNC GTs who remain in a position to be able to discharge such obligations through an entity they collectively operate;
2. Ofgem has a licensed entity (ies) that they are able to look to for performance of licence obligations and against whom they can take effective enforcement action;
3. No requirement to re-open price control as costs already allocated within current price controls.

UNC GOVERNANCE – THOUGHTS AND ISSUES

NGT's preferred solution in relation to the above is option a with the NTS operating the administration functions associated with the UNC however option b with a collective arrangement would offer an alternative solution into the future.