TOTAL GAS & POWER LIMITED

Ms Sonia Brown
Director, Transportation
Office of Gas & Electricity Markets
9 Millbank
London
SW1P 3GE

17th May 2004

Re: **National Grid Transco - Potential sale of network distribution businesses: Agency & governance arrangements Regulatory Impact Assessment (April 2004)**

Dear Sonia,

Thank you for providing Total Gas & Power Limited (TGP) with the opportunity to comment on the above Regulatory Impact Assessment (RIA), at a stage which is very important should you grant National Grid Transco (NGT) the authority to sell one or more of its Gas Distribution Networks (DNs). Our response consists of specific references to the RIA as well as more general issues that we feel must be addressed at this time.

TGP believe that the DNs should all be regulated profit making organisations, regardless of owner. Even if no DNs are sold, we feel that there is merit in separating each DN into separate legal entities, as this will avoid the possibility of transfer pricing issues and benefit comparative regulation.

TGP agree with Ofgem's view that competition should not be detrimentally affected with the implementation of an agency framework. However, we recognise concerns that the implementation of a monopoly agent will leave no ability for shippers to tender for alternative services from DNs as, for many activities, the agent will be the only point of contact. Additionally, the agency will also be in a monopsony position, as sole purchaser of services from DNs. While TGP are fully of the opinion that a broad agency is the best way forward should NGT sell any of its DNs, sufficient procedures and controls must be implemented, such as Standards of Service incentives, in order to ensure that the agency cannot abuse its unique position in the gas industry.

Although many of the operational issues that will address the necessity for procedures and controls are yet to be addressed, the RIA must attempt to take this into account when examining the costs and benefits of any sale. For example, steps should be taken to ensure that the agency does not encourage a shipper to remain with the incumbent meter provider once the new metering arrangements are adopted in July 2004.

Due to the strong possibility that the DN sale could occur whilst under NGT's current price controls, TGP believe that it is necessary to strip the current price controls into their separate components for all areas that are being considered for the Agency, as specific components will allow costs and benefits to be assigned to the correct activity. This will not only increase the accuracy and transparency of the RIA, but also raise the meticulousness of comparative regulation exercises. Furthermore, in separating the price control components to accurately reflect activities, it is necessary to incorporate costs and benefits that arise from NGT, end-users, shippers and suppliers. An agency option must not be adopted where it appears that the benefits outweigh the costs without taking account of shipper and supplier costs. As such, TGP are of the opinion that it is necessary for NGT to undertake a form of negotiated compensation in order that shippers and suppliers costs are not ignored. If benefits exist for NGT and DNs but costs are imposed on shippers commercially all parties should be able to negotiate a mutually agreeable situation. This is required for both the initial DN sale and any subsequent change proposed by any or all DNs, whether independent or retained.

Furthermore, whilst TGP believe that it is necessary to split the price controls into individual components in order for the RIA to be as thorough as possible, it will be necessary to take account of costs borne by shippers and suppliers from different agency arrangements, as inevitably these costs will be passed to end-users. More specifically, a situation may arise where an option is adopted which appears to lead to a position where the benefits outweigh the costs for NGT and end-users. However, if shipper and supplier costs are included, the option may lead to costs outweighing the benefits.

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In increasing the transparency of the RIA, it should include all issues that need to be addressed that will result should the authority grant a sale. TGP are of the opinion that it is necessary to codify all services that will be affected. For example, as stated earlier, in order to ensure that the agency does not abuse its monopoly and monopsony position, the standards of service measures must be quantified, the impact of the DN sale measured under each option and included in the RIA.

With regards to governance, TGP feel that there should be a Unified Network Code (UNC), as any other governance arrangement will increase complexity for shippers and hence result in costs to end-users. We continue to be very concerned about the potential for eventually moving to a fragmented situation with effectively "no agency" and the resultant huge cost consequences. A UNC supported by strong regulatory checks to maintain uniformity is the only mechanism proposed to date in which TGP have any confidence. The RIA does not take account of the costs that could arise should differing governance arrangements arise. More importantly, TGP are unaware of the stage of development of the UNC. Issues such as these must be included within the RIA before any decision is made as to which option to pursue.

Although options A to F assume that Network Code and Distribution Charging development remain with individual DNs, it is still possible that these activities will have an impact on other activities. If it is assumed that these activities costs and benefits remain constant regardless of options A through to F, then they should not be included in the RIA, as there may be some cross over costs and benefits that are not clearly stated, leading to a loss of transparency. As highlighted at work groups and our responses to past consultations, it is paramount that Ofgem's other reforms, for example the exit capacity regime, are not included in this and other subsequent RIAs, as these will continue regardless of whether a DN is sold.

With regards to specific options, "Option B: Introducing a Governance Entity", the document states that the model was developed during work group discussions, with the group formulating the variations in option B. However, it is our understanding that the model was merely presented to the work group by Ofgem for comment. Shippers did not accept that credit and cash collection costs were immaterial with regards to DNs handling these actions. More importantly, the RIA does not illustrate the clear difference in net costs between the narrow and broad agencies. This, it is felt, is due to the fact that the RIA has not taken account of shippers and suppliers costs fully. Such discrepancies lead TGP to harbour the opinion that there may be many more errors in the RIA's methodology, and hence its conclusions. There are many reasons for this, which we detail in the following paragraphs.

The "Key Issues" chapter refers on more than one occasion that it is suppliers that conduct Supply Point Administration (SPA) processes. However, it is shippers, not suppliers, which conduct SPA.

As indicated previously, TGP are unaware at what stage the UNC development is at, and hence do not understand how the RIA can take account of long term governance issues. As paragraph 5.9 indicated, it is not clear how the governance entity is funded past 2007/8. This could have a significant impact on the preference for option B, and such issues must be identified and included in order to obtain a meaningful RIA.

TGP feel that there is a necessity for Ofgem to clarify the role of the agency in Connections and Site works. TGP's understanding of these activities is that the agency will merely manage data flows, and not undertake any business functions, such as tendering for these activities. Therefore, we feel that the RIA is incorrect in assigning costs and benefits as illustrated in table 8.1.

TGP do not agree with the manner in which Ofgem has compared the costs and benefits arising from each option. Options A to F should be compared against the costs and benefits that will arise with both the sale going ahead with no agency and the possibility that no DNs are sold. We feel that the magnitude of each issue and activity is not dealt with adequately in the RIA, and hence believe that there is much room for improvement. TGP feel this is illustrated in table 8.1 as, for example, credit and cash collection are given an equal weighting throughout each option, even though the options deal with the activity in different ways. As indicated previously, credit and cash collection is a material issue, and the fact that a shipper will need credit arrangements with eight DNs and an agency means that costs will be higher for option B1 than it would be for option E.

The RIA has suggested that it could be necessary to split the RGTA and AT-link components of Gemini. TGP feel that Gemini should continue to undertake RGTA and AT-link functions, and under no circumstances should be split. Any split will result in a significant cost for the industry.

To reiterate an important point, TGP feel that whichever agency option the industry decides to pursue, it is important that a strict set of governance arrangements and appropriate criteria are in place to ensure that fragmentation does not occur in the long run, as this will result in significant costs, far outweighing any benefit of a move to independent DNs.

Should you wish to discuss our response further, please feel free to contact me.

Yours sincerely,

(This message is sent electronically and is therefore not signed)

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