

## National Grid Transco

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Dear Sonia,

**Re : Agency and governance arrangements, regulatory impact assessment**

NGT welcomes the opportunity to provide input to this regulatory impact assessment covering the various options for the development of appropriate agency and governance arrangements, to provide for shipper and consumer interfaces, associated with NGT's proposal to sell one or more of its networks.

Following approval by the Gas and Electricity Markets Authority in April for work to proceed to establish the most appropriate arrangements for agency and governance, NGT has been active in exploring the various options through and in support of the workgroup process.

**NGT's proposal**

NGT's initial approach has been to develop a solution that facilitates a multiple transporter environment and to do so efficiently by minimising the amount of change required whilst maximising the benefits. NGT continues to believe that, consistent with the input provided throughout the workgroup discussions, Option A best protects the interests of gas consumers, by promoting efficiency and economy on the part of licence holders. This option continues to facilitate the competitive gas supply market and provides a platform for the development of future industry initiatives to further develop competition in gas supply, such as the supply point administration processes.

NGT's proposal also ensures appropriate accountability. Fundamentally, this ensures that following the sale of one or more networks, all gas transporters - that is the national transmission transporter ("NTS") and distribution ("DN") transporters continue to be responsible under the gas transporters' licence for the obligations contained in Transco's existing licence, with some additions in order to accommodate both new arrangements (such as Uniform Network Code) and the appropriate division of existing aggregated arrangements (i.e. conditions relating both to transmission and distribution).

Under this option, gas transporters retain primary responsibility under their licences for the discharge of these obligations. The role of the Agent is subcontractor to each of the gas transporters; each DN and NTS. This has two key advantages. First, this preserves the delivery of these activities within existing funding arrangements for the remainder of the existing price control. Second, it avoids the requirement for any new separate licensable activity to be created and the consequent cost and complexity. We believe that this would represent an unnecessary extension in the scope of regulation.

NGT's proposal would ensure, as a minimum, continuation of the existing quality of the service by Agency. Ofgem's ability to exercise control over these activities will however provide an important safeguard for the industry in this respect. Ofgem's power to enforce the gas transporters' licence does, however, raise an important issue. For this function to work, the gas transporters must be able to collectively exercise control over the Agency. This is because the gas transporters will be dependant upon the contractual promises of the Agent for fulfilment of their licence conditions.

Without this control, gas transporters could be in the invidious position of potentially being unable to comply with their licence. This would not be an appropriate arrangement. For the same reasons, joint governance of Agency by the gas transporters through joint ownership and board representation is the most appropriate way to ensure that gas transporters can deliver their licence obligations.

NGT believes that the scope of its proposal is right but recognises that Ofgem and industry participants have raised certain concerns. NGT has the following comments on some of the concerns raised and on the potential solutions.

### **The governance entity**

The concept of having a governance entity raises a number of issues and these are considered below. In general, NGT does not consider that the introduction of a governance entity is necessary in order to address the concerns raised and sets out below alternative proposals to address these concerns. In the event that Ofgem decides that a governance entity is appropriate however, there are a number of consequences that need to be understood.

The creation of a governance entity has implications for increased cost, source of funding and quality of resource. Costs would inevitably increase as a result of creating a new entity and particularly if there was a requirement for the resources of the governance entity to be ringfenced from other parts of gas transporters. On funding, the creation of the governance entity would of course, take the delivery of these arrangements outside existing price control arrangements and additional funding would undoubtedly be required. NGT is also concerned that the governance entity would find it difficult to attract and retain the calibre of resources required to discharge the functions of the governance entity effectively. This is because current resources used to discharge these functions have a mixture of business expertise and administrative responsibility. The resources that have the necessary expertise to conduct this activity are unlikely to find a move to the governance entity to be an attractive prospect, preferring to remain in a role in NGT or a DN that has greater development potential and does not dilute their expertise. The governance entity might therefore find itself without the necessary skills that would be crucial to its success.

Whilst NGT agrees that the governance entity could be made to work, it is hoped that any decision to do so does not overlook these important considerations; particularly in view of the existence of effective and more efficient alternative solutions. In this respect, NGT notes that the principal driver for the creation of the governance entity is the perceived potential for Transco to discriminate against other DN gas transporters in the Network Code modification process, which NGT believes is frequently overstated and not, in practice, a problem.

Protection against undue discrimination in the network code modification process already exists, since Transco has (and will continue to have) a licence condition prohibiting such action. Any breach of this condition, even if unintentional, would be subject to enforcement action by Ofgem. NGT treats this prohibition very seriously. Second, as part of the network sales process, NGT proposes revisions to the existing network code modification regime to ensure suitability for multiple transporters (i.e. the Uniform Network Code modification rules). These adapt the modification rules to give greater protection to all transporters. These include :

- Removal of "the NGT veto" – this is a misnomer and at worst is the ability to delay a proposal by one month
- Extension of the existing role of the panel to make formal recommendations
- The ability of the Panel and Transporters to view reports in draft
- Timetabling of decisions to be made by the panel rather than NGT

NGT believes that the combination of licence conditions that prohibit discrimination; together with the proposed changes to the modification regime provide effective safeguards against discrimination. NGT contends that the scope for discrimination is low and further measures are unnecessary and inefficient.

As with the Agency, if a separate governance entity were to be considered, NGT believes that this should be comprised of the licensed gas transporters. Moving to a wholly independent organisation would limit gas transporters' ability to deliver their licence obligations. It would also remove gas transporters' ability to control the costs of this activity.

#### **Including a metering and connections "postbox" in the Agency**

The proposal for the provision of a postbox and routing service in the Agency for metering and connections work is not a proposal that NGT supports. NGT agrees that the potential for competition in metering and connection to be negatively impacted outweighs any perceived upside of this proposal. In addition, this would undoubtedly impose further hand offs and systems costs to both NGT and shippers/suppliers.

#### **Credit and cash collection functions for DNs**

NGT agrees with the view that responsibility should lie with DNs; to ensure that the most efficient set of credit arrangements continue to exist.

#### **Demand estimation**

NGT proposes that the demand estimation activity should be delivered, on behalf of all transporters, by NTS, under a Demand Estimation Services Agreement (DESA). This approach ensures efficient provision of this service, promotes transparency and open governance and mitigates the risk of inefficient industry fragmentation associated with this activity.

Demand Estimation is a technical function defined within the Network Code which inputs into several key processes including the daily balancing regime, the NDM nomination processes (ahead of and within day), and the determination of NDM supply point capacities (SOQs) and annual quantities (AQs). Demand Estimation also includes the definition of weather variables that input to other significant broader processes including the performance of the NDM profiles and management of the sample of NDM supply points from which daily consumption data is sampled to enable NDM profiles to be developed.

Governance of this activity is through the Demand Estimation Sub-Committee (DESC), which is required by Network Code. DESC comprises representation from Transco, Ofgem and shippers nominated by the Gas Forum. DESC has consistently operated without difficulty on a consensual basis and Ofgem has never found it necessary to exercise its power of veto of DESC's annual proposals. In the future it is anticipated that DNs will also participate in DESC. NGT believes that this is the most appropriate governance for demand estimation going forward.

Demand estimation and demand forecasting activities are inter-dependent processes. Following network sales, NTS will continue to have obligations in respect of the economic and efficient development and operation of the NTS and to satisfy these core requirements NTS expects to conduct demand forecasting activities in relation to the full GB market. This provides strong efficiency reasons for retention of the demand estimation activity with demand forecasting, within NTS. To ensure consistency and efficiency, NTS will continue to provide demand forecasting services to the retained DNs and will offer these services to independent DNs also.

NGT notes the proposal for the agency, in the future, to perform demand estimation services. NGT estimates that this would cause a loss of efficiency of between £2-3million (over the first two years) with an ongoing increase beyond that of at least £250,000 per annum.

These efficiency losses arise through a direct increase in the number of staff involved in these functions across Agency and Transmission (4 people) and inflation of other costs, for example those associated with separation of currently integrated analytical processes, consequential duplication of systems, additional weather data costs and statistical software modelling licence costs.

In addition, recent experience has demonstrated that the skills to carry out this work are in very short supply. Consequently NGT has had to recruit and extensively train individuals in order to avoid expensive long-term consultancy input. In the short term, and based on the recent

experience, it would be necessary to procure such services at least in part via consultants. It is estimated that the total additional annual costs would be between £1-2million. In the longer term (perhaps after two years) and dependent upon the recruitment and training of in-house staff, these incremental costs might reduce at best to around £250,000 per annum. Splitting demand estimation from demand forecasting would also leave the smaller groups vulnerable to skill shortages when key personnel leave.

NGT proposals would minimise disruption to shippers with the DESC continuing to be supported and resourced by the current experienced staff. This would promote industry confidence and a high degree of transparency and interaction with the community in respect of the demand estimation activity. Given the low expected cost of the DESA, it is also unlikely that DNs will want to develop individual approaches therefore preserving a uniform, consistent and intellectually robust approach to the demand estimation activity.

### **Systems ownership**

NGT supports the general view that wherever possible, responsibility for systems should reside with the entity that is dependant upon those systems as a way of ensuring efficiency by ensuring alignment of accountability and obligations.

This raises a number of important issues in the context of network sales and the creation of Agency, particularly as it is not always possible to split systems that are already in existence and assign the component parts to other entities immediately. Where there are a number of dependants, then a compromise is needed regarding the timing of transfer of ownership in order to ensure continuity of service and to avoid inefficient separation of IS systems, particularly in the case of Gemini, which is in the course of development.

The majority of NGT's gas systems that are relevant to the industry's discussions on network sales can continue to be aligned with the entity that is responsible for service delivery. In Figure 2, Ofgem has described the IT systems that can be allocated to Agency and those that clearly should remain with NTS. There are however two systems that provide functionality to both the NTS and to Agency; AT Link and RGTA, shortly to be replaced by a new system Gemini. Gemini cannot be readily separated from NTS or split. Gemini is currently under development and careful consideration needs to be given to the allocation of this system both in the short and longer term.

NTS is the primary user of these systems. These systems are of fundamental importance to NTS operations in the system operation activity (particularly in respect of ahead of day and within day activities). Additionally the systems generate primary data that is essential to the invoicing of NTS transportation charges. These systems will be essential in order to satisfy the obligations that will remain with NTS (particularly in respect of the derivation of individual shipper imbalances). In view of this and considering the current development work to Gemini, NTS needs, in the short term, to retain these systems. Retention of these systems by NTS is consistent with the current price control arrangements (NGT is funded through the Transco SO control to replace AT-Link / RGTA with Gemini).

NGT recognises that these systems also provide a primary operational interface to shippers and are essential to DNs in the discharge of some of their obligations. Indeed these systems also provide essential data to support DN transportation billing. Therefore in the longer term it may be appropriate to consider other options for ownership of these systems, or indeed some form of separation of these systems. Whilst separation would offer the greatest clarity, it is unlikely to be economically attractive until the system is being replaced or substantially updated. NGT believes that the appropriate time for this issue to be considered is at the time of the next price control review. Under these circumstances the transfer of these systems to Agency (or an infrastructure provider) might be appropriate.

From Day 1 therefore, Options A and B are the options that best manage the systems issues, as set out above. NGT has the following comments on other options proposed.

Option C – putting Gemini with Agency

NGT notes that the operational system integration benefits that are associated with Gemini would benefit Agency, however, a number of disadvantages arise under this proposal. First, this introduces the potential for inefficiencies by splitting service delivery from ongoing system development. The expert knowledge associated with Gemini system design, implementation and operation lies within UK Transmission and therefore ownership by Agency would either necessitate access to key NTS staff (particularly in the context of system change and impact assessments) or the transfer of additional staff to agency. IT is NGT's view that any benefits associated with the common ownership of all UK-Link systems by Agency in Option C are more than outweighed by the risks of reduced accountability and the risks generated by the additional "hand-offs" associated with an industry critical real-time operational system. This would also be inappropriate given the current SO price control settlement.

#### Option D – Allocate systems with responsibilities

Whilst this option has strong merits in respect of accountability, this option could generate increased, and inappropriate, risk of inefficient industry fragmentation. This option anticipates each network operator developing its own nomination systems. This may necessitate shippers having to interface to more than one IT nomination system. Additionally given the nature of the current NDM attribution process each nomination processing system would need to either replicate similar processes or to effectively pass aggregated nomination data to another central system to perform the NDM attribution process for each LDZ in line with Uniform Network Code requirements. Independent systems would therefore introduce inefficiencies and possibly increased risk of inconsistency and fragmentation of the NDM processes.

#### Option E – splitting RGMA and AT Link / Gemini

From the options presented, Option E raises a particular concern as it considers splitting Gemini with RGTA entry capacity components to be owned by NTS and AT-Link components to be placed in Agency (and presumably held in common ownership). NGT has performed a high level impact assessment of this proposal to assess its potential impact on the current programme and to establish any potential incremental costs. NGT considers that such an initiative would generate substantial additional risks to the delivery of the programme and to increased costs of up to £10m (taking account of both extra development costs and necessary infrastructure investment). Support for Option E appears to arise from the desire to establish clear accountabilities for the provision and ongoing development of the systems, but NTS would still retain these responsibilities, including the delivery of any changes required under the Network Code and UK-Link Committee, during the current price control period. NGT believes that the costs associated with Option E would be inefficiently incurred and hence Option E should be rejected.

Overall, on systems, NGT considers that the most appropriate decision in respect of the Gemini systems would be for ownership, and therefore responsibility for ongoing service delivery and development, to remain with NTS for the duration of this price control. NGT recognises that in the longer term, given the importance of the Gemini system to both shippers and to DN's, that a shared ownership/separation concept warrants consideration. NGT advocates that such a proposal, including the funding arrangements, is considered at the time of the next price control review.

NGT concludes therefore that Option A is the most appropriate solution, with the potential for aspects of this option to evolve, as indicated, over a period of time.

I hope this is helpful. I would be pleased to assist if further information on or clarification of any of the issues raised would be helpful.

Yours sincerely



Chris Train  
**Director**