



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

9th July 2004

Dear Sonia,

**National Grid Transco – Potential sale of gas distribution network businesses
Offtake arrangements Regulatory Impact Assessment
Gemserv response**

Thank you for the opportunity to respond to Ofgem's Offtake arrangements Regulatory Impact Assessment. Ofgem has asked for views regarding the most appropriate high level governance for the offtake arrangements. Gemserv has limited its response to a consideration of the governance regime that will best facilitate the evolution of the offtake arrangements, with regard to the relevant objectives.

Gemserv aims to utilise its broad experience in the design, development and operation of robust governance regimes to pave the way for a diminution of regulatory intervention allowing self-regulation within utilities to develop. Self-regulation within well developed complementary governance regimes will allow all stakeholders (including customers) within the industry to play an appropriate part in shaping the pace and direction of change. This will result in a well ordered, efficient and competitive market place with no single participant or interest group able to dominate. Gemserv's experience of the governance of electricity markets, which support multiple distribution system operators, gives it a unique position from which to offer a response.

Gemserv's position is that governance under an inclusive Universal Network Code offers clear and unambiguous net advantages over the alternative of a proliferation of separately governed offtake codes. The choice of governance arrangements is particularly important if there is a likelihood of the allocation of Exit capacity evolving into a shipper booking model.



The offtake arrangements describe and govern the commercial and operational arrangements applicable at the interface between the DNs and the NTS, following a DN sale. The post-sale industry structure must both establish a relationship between the NTS and DNs that permits each network owner to fulfil its own statutory and licence obligations; and follow the principles of good governance.

Any offtake agreement governance should be effective, efficient, and transparent. It should allow appropriate participation, facilitate accountability of the parties and be consistent with other governance regimes. Further to these established principles, Gemserv suggests three additional characteristics. Firstly, that governance should be balanced and impartial, so that the agreements and rules for change control are operated for the benefit of all legitimate constituencies and without undue influence from any one of them. Secondly, the agreements and governance framework should have overall criteria by which to judge the desirability of change. Thirdly, Gemserv believes that the ability of all parties to propose changes in the modification process is important to prevent any party or constituency from skewing the process in its favour.

Governance under an inclusive Universal Network Code would best adhere to these principles of good governance. Proliferating governance regimes introduce fragmentation and inconsistency, which leads to inefficiency, cost and risk for industry participants. This can ultimately frustrate change and should be avoided wherever possible.

An inclusive code would offer the assurance of clear obligations and signing onto it would confirm an acceptance of compliance requirements. A defined change process for an inclusive code would offer considerable savings compared to bespoke operator-to-operator contracts, consistent with the principle of efficiency. If each operator undertook a discrete dialogue and negotiation process, they would incur increased costs and the degree of transparency and participation is likely to be diminished. Standardisation of offtake arrangements reduces complexity and provides greater certainty and clarity of obligations. However, in so far as certain terms may be specific to and dictated by the physical characteristics of a particular offtake it would be entirely feasible to envision a series of schedules containing the minimum set of specific terms for each offtake. Differing requirements are not precluded by a code that provides the common framework as well as the flexibility to allow for certain specific distinctions.

The principle of participation suggests that all connectees to the NTS should be parties to the offtake arrangements. Change proposals based on a majority of parties' needs and views are likely to reflect efficient, timely and cost effective solutions. As all parties' views can be fed into the



process, agreed solutions are likely to foster industry best practice, and be appropriate for the market as a whole.

The governance regime should include a clear right of appeal to a panel. A standardised appeals mechanism is less costly than a legal contract dispute or a regulatory determination. The appeals mechanism also allows companies to demonstrate their regard to the considerations of their customers and stakeholders, by following a due process route when they have fundamental concerns with a decision or change. This is consistent with the principle of effectiveness and compliant with the present drafting of the Energy Bill.

Gemserv supports the view that the chosen framework should require minimal ongoing regulatory intervention. An inclusive governance arrangement would reduce transaction costs and improve the timeliness of changes necessary to reflect external factors such as new legislation, for example, future European Union gas regulation. Industry has in the past experienced the difficulties in achieving an agreed 'go live' date for a significant change where changes have to be processed through separate governance regimes, to different timescales.

Furthermore, the secretariat for the governance of the Universal Network Code, incorporating offtake code arrangements, would be most effectively delivered through an independent governance services provider, following a competitive tender. This approach would offer greater assurances of transparency and non-discrimination, coupled with the cost minimisation benefits of competitive tendering. An independent governance entity would find it easier to allow decision makers to have full access to all relevant information on a non-discriminatory basis, and for the industry to perceive that information is provided without undue discrimination.

I hope you find these comments useful, should you wish to discuss anything further in this response then please contact Richard Gray, telephone 0207 090 1015, email richard.gray@gemserv.co.uk.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Nigel Bromley".

Nigel Bromley
Chief Executive