

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

**Initial thoughts on restructuring of
Transco plc's Gas Transporter Licences**

Consultation Document

September 2004 215/04

Summary

Purpose of this document

In May 2003, National Grid Transco plc (NGT) publicly announced that it would consider the sale of one or more of Transco plc's (Transco) local gas Distribution Networks (DNs) if it were to maximise shareholder value. Such a sale would represent a fundamental change to the structure of the gas industry. Any sale of DN assets by Transco would require the consent of the Gas and Electricity Markets Authority (the Authority), the Health and Safety Executive (HSE) and the Secretary of State for Trade and Industry (the Secretary of State).

As part of the process of the proposed disposal, in July 2004 Transco applied for eight new additional gas transporter (GT) licences relating to each of its DNs. Consultation on these applications is due to end on 24 September 2004. Subject to the consideration of respondents' views, it is envisaged that at least five new additional GT licences will be granted to Transco to accommodate four potential independent gas Distribution Networks (IDNs) and Transco's retained DNs (RDNs). It is envisaged that the new additional GT licences would (if granted), initially largely mirror Transco's existing GT licence.

In light of Transco's commercial timetable, it is necessary to give thought to the regulatory structure in the event of a sale of one or more DNs even though the consultation on the licence applications is on going. The purpose of this document is to consult upon Ofgem's initial thoughts on the possible modifications to Transco's existing GT licence and if granted, the new additional GT licences in the context of the proposed sale of one or more DNs by Transco. This does not fetter the discretion of the Authority regarding any decision it may have to make in respect of DN sales, including without limitation, any decision regarding the grant of the additional GT licences. These modifications, both to the content and structure of the licences, would be required to ensure that the regulatory framework will be able to support the divested industry structure that would occur should one or more DNs cease to be owned by Transco.

It is important for respondents to be aware that aside from normal modifications to Transco's existing GT licence which will continue regardless of DN sales, Ofgem will review the need to modify Transco's existing GT licence and, if

granted, the new additional GT licences as part of the DN sales process at three separate stages:

- ◆ The section 23 notice;
- ◆ The section 8AA consent; and
- ◆ Further conditions as part of the consent to disposal of the relevant DN assets under the Amended Standard Condition 29 (Disposal of Assets) of Transco's existing GT licence. Transco will request consent to disposal of the relevant DN assets to new wholly-owned subsidiary companies (DN companies). Subject to the Authority's deliberation on this point, it is likely that any such consent would be subject to, amongst other things, a condition requiring Transco to retain ownership of the shares in the new companies. Subsequently, Transco will ask the Authority for consent to the disposal of the shares to third party purchasers. It may be possible that some modifications to Transco's existing GT licence and, if granted, the new additional GT licences would be required as part of this process.

Ofgem has flagged in this document the various areas of the licences it expects it may seek to modify at these various stages. However, this is an iterative process and the suggested modification points are not binding on the Authority. Ofgem's intention is, subject to resolution of policy issues and addressing any issues raised by respondents, to make as many of the changes as possible through the section 23 process. However, this may not be possible and it may mean that some issues need to be addressed at the section 8AA stage or even as part of consent to disposal.

This document gives a high-level outline of the issues surrounding each licence condition in Transco's existing GT licence and Ofgem's initial view of the proposed licence structure. The document also includes initial views of proposed changes to licence conditions and outstanding issues. This document does not constitute a formal licence modification consultation. A section 23 notice will be issued in November 2004, and Ofgem is inviting views on this document in order to help inform the content of that notice and to inform Ofgem's thinking in relation to the section 8AA transfer process and as regards consent to disposal of the shares in the DN companies.

In order to make modifications to the conditions of each of Transco's GT licence (i.e. Transco's existing licence and, if granted, the new additional GT licences) Transco's consent will be required in accordance with the requirements of section 23(6) of the Gas Act 1996 (the "Gas Act") as it will be the holder of the relevant licences at the relevant time. This means that only Transco will be asked to provide consent to the modifications to its existing GT licence and, if granted, the new additional GT licences. This consent, if provided by Transco, would enable the Authority, but not oblige it, to direct that the modifications be made and this would be the first step in prescribing the content of the licences for the NTS, the DNs to be sold and for the RDNs. As explained above, further modification may occur via the section 8AA process and as part of the consent to disposal of the shares in the DN companies.

However, in light of the proposed sale of the DN businesses, Ofgem would particularly hope to receive comments on the proposed changes to the content and structure of Transco's existing GT licence and, if granted, the new additional GT licences from, amongst others, potential DN purchasers and other interested parties in order to inform its thinking on the content of the section 23 notice and in due course the section 8AA process and the consent to the disposal of shares in the DN companies.

In issuing this document and describing the proposed regulatory process to be followed, and setting out a summary of certain licence conditions as currently contained in Transco's existing GT licence, it is important to make clear that there can be no expectation on the part of NGT, Transco, potential DN purchasers, shippers, suppliers, Independent Gas Transporters (IGTs) or any other interested parties either as to what the Authority's final decision in relation to the proposed transaction may be, or as to the regulatory framework which may be implemented if the Authority consents to the proposed transaction.

The information and the details of the proposed future treatment of certain licence conditions and the summaries of the licence conditions in Transco's existing GT licence contained in this document should not be treated as binding on the Authority. Nothing in this document is to be construed as granting any rights or imposing any obligations on the Authority. Finally, the Authority's discretion in this matter will not be fettered by any statement made in this document.

Background to this document

Following Transco's announcement of the proposed sale in May 2003, in July 2003, Ofgem issued a consultation document on the regulatory, commercial and operational changes which would be required to facilitate any sale of one or more DNs.¹ Following this consultation, in December 2003, Ofgem issued its Next Steps document setting out responses to the July 2003 consultation, Ofgem's current views and a proposed way forward for considering NGT's proposals including the establishment of workgroups to take forward the development of a commercial and regulatory framework.²

Since the release of the December 2003 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 (AWG) to continue the proposed DN sales consultation process. Each of these workgroups has met regularly since January 2004 (although issues which were initially being considered by the RAWG were more recently considered by the DISG). The workgroups have provided industry participants with an opportunity to contribute to the development of a commercial and regulatory framework that would enable the implementation of Transco's proposals, should Transco obtain the necessary consents.

In light of these discussions, Ofgem issued a way forward document in March 2004, indicating that it would be appropriate to develop for consultation separate Regulatory Impact Assessments (RIAs) on certain issues.³ Ofgem considered that the release of these RIAs would be consistent with the Authority's duty to carry out impact assessments.⁴

In April 2004, Ofgem released two RIAs relating to the potential sale of one or more DNs. These assessed different options for both agency and governance arrangements, and the appropriate allocation of roles and responsibilities between the NTS, the RDNs and the IDNs, following the sale of one or more

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

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

³ *'Potential sale of gas distribution networks, Ofgem update on way forward'*, Ofgem, March 2004.

⁴ This duty is contained in section 5A of the Utilities Act 2000.

DNs. In May 2004, following a period of consultation, Ofgem released indicative conclusion documents in respect of both of these issues⁵. In June 2004, Ofgem issued two RIAs relating to offtake and interruptions arrangements, followed by two indicative conclusions documents in August 2004⁶.

Ofgem also issued an open letter to industry participants setting out the regulatory timetable for Transco's proposed sale of DNs on 16 July 2004⁷.

Regulatory framework

The key elements of the regulatory framework relevant in the context of the proposed DN sales are the Gas Act, and the Transco's existing GT licence.

The Gas Act

The Gas Act provides for the regulation of the onshore gas regime in Great Britain and for the separate licensing of GTs, gas shippers and gas suppliers. The Gas Act provides that the principal objective of the Authority in carrying out its functions under the Gas Act is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate, by promoting effective competition between those engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas.

The Gas Act also provides for the licensing of activities relating to gas. These include the licensing of GTs, gas shippers and gas suppliers. Section 23(1) of the Gas Act sets out the process for modifying licences for which there are a number of different procedures. These are:

- ◆ **Collective licence modification (CLM).** The CLM procedure deals with the modification of standard conditions under section 23(1)(b) of the Gas Act. The Authority may bring forward proposals for licence modification and the CLM arrangements enable relevant licence holders who are not

⁵ *National Grid Transco – Potential sale of gas distribution network businesses, Allocation of roles and responsibilities between transmission and distribution networks* Ofgem, May 2004 and *National Grid Transco – Potential sale of gas distribution network businesses, Agency and Governance Arrangements* Ofgem, May 2004.

⁶ *National Grid Transco – Potential sale of gas distribution network businesses, Interruption arrangements, Conclusions document on framework*, Ofgem, August 2004 and *National Grid Transco – Potential sale of gas distribution network businesses, Offtake arrangements, Conclusions document on framework*, Ofgem, August 2004

⁷ Ofgem Open letter: Timetable for Potential Gas Distribution Network Sales Project.
http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7883_timetable_letter_july04.pdf

content with a proposed modification to a Standard Condition to register their formal objection. It enables the Authority to introduce a modification to a standard condition where a specified percentage of licence holders have not objected.

- ◆ **Individual consent.** The individual consent process as set out in section 23(1)(a) of the Gas Act requires the Authority to gain the consent of each relevant licensee prior to modification of the licence. This process can be used either in relation to amending Standard Conditions for individual licensees or for the introduction of new Special Conditions in the licence or amendment to the same. This process, when used in respect of Standard Conditions, has the effect that the modified Standard Condition is not subject to the CLM procedure to the extent that it has been modified.

In the absence of obtaining consent either through the CLM procedure or the individual consent of the relevant licensee, the Authority may refer the matter to the Competition Commission for resolution.

Under section 8AA of the Gas Act, a licence is capable of being transferred by the licence holder with the consent of the Authority, in accordance with the section, and any terms of the licence relating to its transfer. This may include conditions which must be complied with before the licence can be transferred.

Transco's existing GT licence

Transco is currently the holder of a GT licence issued under the provisions of the Gas Act⁸. This covers the operation of its high pressure transportation business, largely the NTS, and its lower pressure distribution business largely on the DN's. It also applies to LNG storage arrangements and metering. Looking at the conditions in Transco's existing GT licence, it is clear that some relate to its NTS operations, some relate to DN's operations and some relate to both. The licence currently has no distinction between conditions relating to the NTS and DN's. As such, it is clear that Transco's existing GT licence covers many aspects of its business on an integrated basis reflecting the fact that the NTS and DN's have been operated within a single legal entity and under one licence,

Currently, Transco's existing GT licence has three types of conditions⁹: These are as follows:

- ◆ **Standard Conditions.** These are applicable to all holders of GT licences unless otherwise modified or specified and were designated by the Secretary of State in September 2001. These have been updated by Ofgem since that time pursuant to the CLM procedure;
- ◆ **Amended Standard Conditions.** These are conditions where the wording of the Standard Condition has been amended with the consent of the relevant licensee (i.e. pursuant to section 23(1)(a) and 23(6) of the Gas Act) to reflect a particular need or characteristic of the licensee. The amendments are not subject to the CLM procedure; and
- ◆ **Special Conditions.** These are specific to individual licensees and have been introduced with the relevant licensee's consent (i.e. pursuant to section 23(1)(a) and 23(6) of the Gas Act) in order to reflect a particular need or characteristic of the licensee.

All standard conditions in GT licences are currently split into 3 sections, as follows:

- ◆ Section A of the Standard Conditions contains conditions relating to interpretation, application and payments;
- ◆ Section B of the Standard Conditions contains general provisions; and
- ◆ Section C of the Standard Conditions contains transport services obligations.

Conditions contained in Section C of the Standard Conditions are currently the only ones in the GT licence capable of being switched on or switched off by a direction of the Authority issued with the relevant licence holders consent (pursuant to Standard Condition 2).

⁸ In addition to Transco, independent gas transporters (IGTs) are also holders of GT licences.

⁹ The Gas Act 1986 refers only to conditions or standard conditions – the terms Amended Standard Conditions and Special Conditions have been developed to differentiate between the types of conditions and the processes of modification applicable to them.

Restructuring Transco's GT licences

Transco's existing GT licence provides the basis for the structure and functioning of both its NTS and DN activities. The potential sale of one or more of Transco's DNs will therefore mean that Transco's existing GT licence and, if granted, the new additional licences, will need to be substantially amended and restructured to be appropriate for a divested network structure. There are also implications for the number of GT licences that will be required in the event of DN sales, proposed structure of the amended licences and proposed licence modification procedures.

Regulatory issues arising from the changes to the GT licences

Ofgem has conducted an initial analysis to assess which licence conditions in Transco's existing GT licence would, in a divested industry structure, be appropriate to transmission activities (which would apply to the NTS), distribution activities (which would apply to the RDNs and IDNs) and both transmission and distribution activities (which would apply to the NTS, RDNs and IDNs). Ofgem has additionally considered whether new licence conditions would need to be introduced to reflect a divested network structure and what the treatment of metering and LNG storage arrangements should be going forward.

This preliminary analysis has concluded that a significant number of modifications would be required to Transco's GT licences (i.e. to Transco's existing GT licence and, if granted, the new GT licences) in order to address the regulatory issues associated with the sale of one or more DNs. This is a direct consequence of the currently integrated nature¹⁰ of Transco's business which is reflected in its current GT licence. The most significant impact of these (potentially extensive) modifications would be that many of the current Standard Conditions would need to become Amended Standard Conditions. As a result, the statutory CLM procedure, contained in the Gas Act, would cease to apply to the Standard Conditions to the extent that they are modified. Given the potential scale of the modifications, Ofgem considers that this would, in practice, make the statutory CLM procedure largely unavailable.

¹⁰ As explained above, Transco's existing licence covers a number of different activities including: transmission; distribution; LNG storage; and metering.

As explained above, the statutory CLM procedure provides the Authority with the ability to modify Standard Conditions across a class of licences without requiring the consent of every holder of such licences. Ofgem considers that to lose the ability to modify consistently GT licences in a divested network structure would not be in the interests of customers nor would it be consistent with its new duty under the Energy Act 2004 to have regard to best regulatory practice.

In the absence of such a CLM procedure, whenever Ofgem proposed a modification to a Standard Condition of a GT licence, it would need to obtain the individual consent of each licence holder. Ofgem considers that there is a risk that this arrangement could result in NTS and DN -T licences diverging and becoming inconsistent which could potentially be detrimental to customers.

As such, Ofgem is proposing to create a procedure equivalent to the current statutory CLM procedure. This "private" CLM procedure would be incorporated into the licence conditions in Transco's existing GT licence and, if granted, the new additional GT licences under the proposed section 23 notice. It would apply to certain specified conditions in the GT licences of the NTS, the RDN and IDNs which, in their revised format, Ofgem considers should remain common to a number of licensees. Such conditions are referred to in this document as the "Standard Special Conditions". This would allow those conditions to be collectively modified to the same effect as if they were Standard Conditions. This is explained in further detail in Chapter 3.

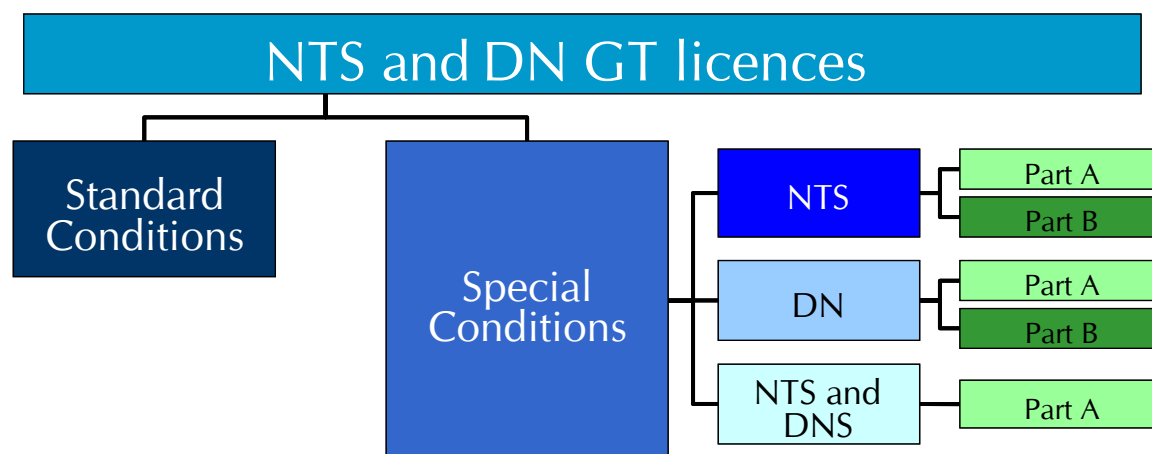
Ofgem would (where possible) seek to revert the Amended Standard Conditions (and certain Special Conditions which currently largely repeat Standard Conditions) in Transco's existing GT licence and, if granted, the new additional GT licences to the Standard Conditions for GT licence holders as designated by the Secretary of State, as updated by Ofgem pursuant to the statutory CLM procedure. However, this may not be appropriate in every case and, where a modification is required to a Standard Condition, instead of using an Amended Standard Condition, Ofgem proposes to repeat the relevant Standard Condition (with the necessary amendments) as a Standard Special Condition which would be subject to the private CLM procedure. This would mean that Transco and the owners of the DNs would be subject to two similar conditions in respect of the same issue. It will therefore be necessary as part of the process for modifying Transco's GT licences, to "switch off" those standard conditions that have been

replaced by Standard Special Conditions. Ofgem therefore proposes to introduce a new Special Condition enabling the Authority to switch on or switch off Standard Conditions in sections A and B, with the consent of the licence holder. This is similar to the power which already exists in respect of section C of the licence under Standard Condition 2.

Proposed structure of NTS and DN GT licences

Based on the regulatory changes set out above, Figure 1 illustrates Ofgem's initial view on the proposed ultimate structure of Transco's existing GT licence and, if granted, each new additional GT licence.

Figure 1: Proposed GT licence structure



Ofgem's initial view is that the GT licences for the NTS and DN (IDNs and RDNs) will comprise of:

- ◆ **Standard Conditions.** These conditions would be common to, but not necessarily operative in the licences of all NTS and DN GTs (as certain conditions would be switched off and repeated in a modified form as Special Standard Conditions);
- ◆ **Special Conditions applicable to transmission only.** These conditions would be split into two parts:
 - ◆ Part A would comprise Standard Special Conditions common or standard to NTS businesses (although it is acknowledged that, in

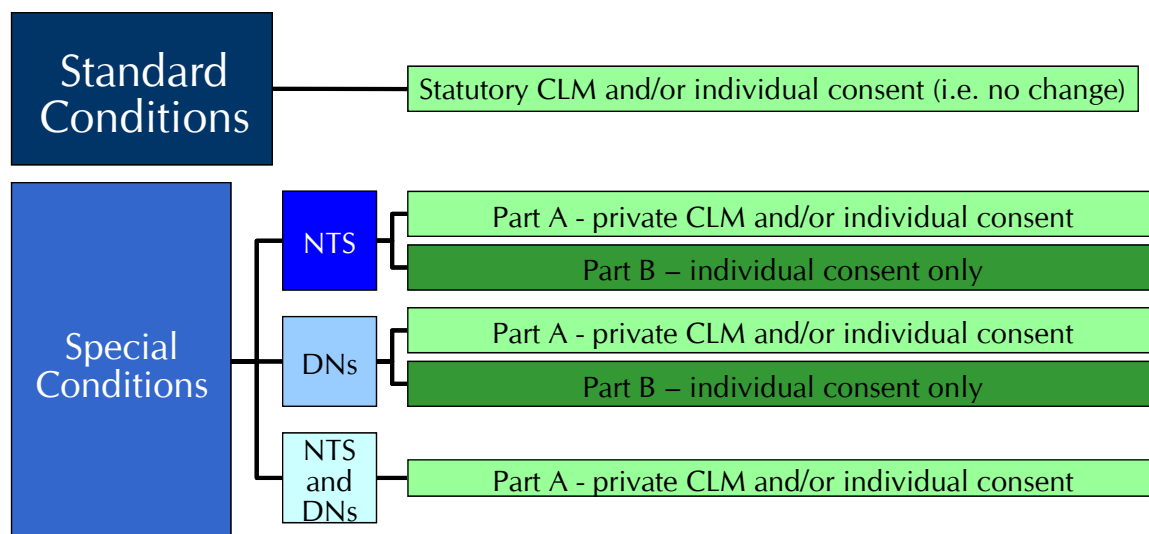
practice, there will be only one NTS on day one post DN sales);
and

- ◆ Part B would comprise Special Conditions unique to individual licensees (i.e. unique to the NTS).
- ◆ ***Special Conditions applicable to the distribution businesses (i.e. IDNs and RDNs) only.*** Once again, these conditions would be split into two parts:
 - ◆ Part A would comprise Standard Special Conditions common to all DNs; and
 - ◆ Part B would comprise Special Conditions unique to individual DNs.
- ◆ ***Special Conditions applicable to both NTS and DNs.*** These would be those Standard Special Conditions common to both NTS and DN activities. There would be no purely special conditions in this section as any required special conditions would be dealt with under the special conditions for transmission or distribution respectively.

Proposed licence modification procedures

The proposed modification arrangements for the revised licence structure explained in Figure 1 are set out in the diagram below:

Figure 2: Proposed modification arrangements



In summary, the modification procedure for Special Conditions under the revised structure would work as follows:

- ◆ **Part A** would contain the Standard Special Conditions which would be subject to the private CLM and/or the individual consent of the licensee where appropriate (as with current Standard Conditions). As can be seen from the diagram, each of the NTS, DN and combined NTS and DN sections would have a Part A; and
- ◆ **Part B** would contain the rest of the Special Conditions which would not be subject to the private CLM procedure and would only be capable of being modified with the individual consent of the licensee as is currently the case with Special Conditions.

Ofgem is still considering exactly which licence conditions fall within each part. In using this structure and modification process, Ofgem's intention is, as far as is practicable and appropriate, to replicate the existing structure of the GT licence as it exists today and to ensure consistency of modifications to ensure that Ofgem's regulatory control is not diminished as a result of the proposed transaction.

Key issues

There are a number of key issues regarding changes to the licensing regime that would be required in the event that DN sales proceeds. These include the following:

- ◆ **Transportation charging arrangements.** Two key concerns arose over the future arrangements. These were that the change in ownership of some of the DNs might bring about differences in the way in which owners of the networks calculate charges for users of their networks. This could cause distribution charges to be updated more frequently as different owners of the networks could choose to update their charges at a number of times throughout the year. An uncoordinated approach to charging and charging methodology changes could impose additional costs on shippers.

Ofgem has considered these concerns and has decided that to mitigate the risk of inefficient fragmentation of the methodology for distribution charging arrangements, the Joint Office (referred to in past Ofgem documents as the “independent governance entity”) should have responsibility for managing modifications to the distribution charging arrangements. In addition, to limit the frequency of changes to use of system charges, Ofgem considers that GTs should be obliged to use reasonable endeavours to announce changes to these charges on one specific date in each year. Given these views, Ofgem believe that it will be necessary to modify extensively Amended Standard Conditions 4 and 4A of Transco’s existing GT licence, which currently set out the licence obligations regarding Transco’s use of system charging arrangements.

- ◆ **Emergency services co-ordination.** The workgroups have discussed three key issues regarding emergency service co-ordination that arise with a change in ownership of some of the DNs, these relating to emergencies at DN boundaries, emergency services provision to IGTs and emergency service provision from the DNs to the NTS.

- ◆ *DN boundaries.* In a divested industry structure, it may not be possible to determine immediately on which network an emergency has arisen at the time the incident is reported (to Transco through the emergency number); for example, if an

emergency is reported close to a network boundary. Ofgem would therefore like to invite views on whether it will be necessary to ensure that the licence condition relating to emergencies ensures that, whichever DN is notified of the incident and despatches an engineer to it, is obliged to make safe the incident regardless of which network it transpires that the incident has actually occurred.

- ◆ *First response emergency services to IGTs.* Currently, if directed to do so by the Authority, Transco must offer to enter into an agreement with other GTs for the provision of emergency services where a major loss of supply has occurred at a “reasonable rate”. These arrangements may no longer be workable under a divested industry structure. Instead, it may be more appropriate to place a licence obligation on all DN-GTs to continue to provide emergency services to all IGTs at a reasonable rate. Ofgem would therefore like to invite views on whether to place a licence condition upon the DN-GTs that obliges them to make available to IGTs only those services considered to be monopoly emergency services, rather than those that might be considered to be available on a commercial basis (such as ongoing repair and restoration services).

- ◆ *First response emergency services to NTS.* Currently, Transco responds to incidents on the NTS with the workforce of the DN in which the incident occurs. Transco have suggested that it would not be efficient for the NTS to provide its own emergency response workforce given the infrequency of incidents on the NTS and the need to respond to any incident within one hour. Transco has suggested that it would be appropriate for the DN-GTs to be obligated under the terms of their licences to provide first response emergency services to the NTS-GT at a reasonable rate. Ofgem welcomes respondents’ views on this issue.

- ◆ **System operator managed services agreements.** Transco intends to put in place a number of network service agreements (NSAs) between DNs and the NTS following the sale of the DNs, allowing many of the

services that are currently undertaken by NTS on behalf of DNs to continue following any DN sales. The workgroups have considered whether it would be appropriate to regulate the NSAs – and in particular, whether system operator managed service agreements (SOMSAs) should be regulated by Ofgem. Ofgem's initial view is that these agreements should be unregulated, and Ofgem invites views on this proposal.

- ◆ **Network Code and offtake arrangements.** To facilitate DN Sales it will be necessary to change extensively the Network Code to reflect the revised commercial arrangements that will accompany any DN disposal. Ofgem's initial view is that the current Network Code will be replaced by a Uniform Network Code (UNC) and Short Form Network Codes specific to each DN that references the UNC. Ofgem invites views on these approaches.
- ◆ **Price controls and incentive arrangements.** The separation of Transco's licence into NTS-GT and DN-GT licences will mean that the current price control arrangements for each DN will need to be appropriately reflected in the DN-GT licences applicable to the DN in question. Ofgem has concluded that it would not be appropriate to reopen Transco's price control on account of the sale of one of more DNs. However, the Offtake Arrangements RIA and the Interruptions RIA concluded that it will be appropriate to place incentives on the DN-GTs to encourage accurate investment decisions by DNs. As such, the DN-GT licences will need to incorporate these incentives arrangements. Ofgem considers that these incentive arrangements will be supplemental to the price control. Ofgem proposes to consider these issues in detail in a separate consultation document to be issued in November 2004.

A further issue for consideration in this respect is the approach to offtake arrangements. In the Authority's indicative conclusions on the Offtake RIA two potential approaches were outlined. These approaches would have different effects on the financial flows under the price controls between the NTS and DNs. Ofgem intends to progress this issue through the workgroup process in the coming weeks.

A final issue with respect to the price control is that the Authority decided in April of this year to introduce the concept of a "safety net".

This is designed to protect customers by reducing Transco's NTS allowed revenue to cover the costs of DN Sales, were only one comparator to emerge from the sales process.

- ◆ **Pipeline security standards.** Standard Condition 16 of Transco's existing GT licence places obligations upon it to develop the pipeline system to meet the peak daily demand for gas such that the ability of the pipeline system to meet that demand is only expected to be exceeded in 1 year out of 20 based on the previous 50 years' of data (the 1 in 20 obligation). Ofgem invites views on whether this security standard should continue to apply to both the NTS and the DNs and hence that future licence conditions should apply to both NTS-GT licences and DN-GT licences.

Licence conditions

This document provides a brief description of each licence condition in Transco's existing GT licence, and a high level view of the changes that are likely to be necessary for each licence condition, along with an indication of the type of condition it may be under the revised licence structure.

This is the first informal consultation on these issues, it is likely that Ofgem will, following full consideration of all respondents' views, further revise the scope and content of the proposed modifications of specific licence conditions. In addition, respondents should note that:

- ◆ the policy issues associated with the ultimate form of the NTS and DN GT licences will continue to evolve between now and the issue of the section 23 notice and may be further refined as part of the section 8AA licence transfer process and as part of the consent to disposal;
- ◆ Transco's existing GT licence will continue to be subject to review and modification by the Authority and will continue to be so modified while this proposed transaction progresses;
- ◆ the document does not purport to contain an accurate or complete summary of each and every issue addressed in each condition currently contained in Transco's existing GT licence, and is therefore not intended to be comprehensive nor are the descriptions binding on the Authority as regards future interpretation of licence conditions; and

- ◆ the proposed modifications included in this document will not apply to GT licences held by independent gas transporters (IGTs) and will apply only to Transco's existing GT licence and, if granted, the new additional GT licences.

New licence conditions

This document also provides a high level view of a number of potential new conditions that might need to be created in Transco's existing GT licence and, if granted, the new additional GT licences to support the potential sale of one or more DNs. Without limitation, these include:

- ◆ "private" collective licence modification procedure;
- ◆ switch on/off of the standard conditions in Parts A and B;
- ◆ implementation of gateway requirements;
- ◆ requirement not to prejudice the systems of other GTs;
- ◆ inter-operator service agreements;
- ◆ governance of technical standards; and
- ◆ arrangements for testing measuring equipment.

Way forward

Ofgem welcomes views on this consultation document, to be received by close of business on 29 September 2004.

While this document provides a high level outline of changes that may be required to Transco's existing GT licence (and, if granted, the new additional GT licences) in the event of the sale of one or more of Transco's DNs, significant further development and consultation is required before such changes could be implemented.

The key steps associated with the licence amendment process are set out in Table 1 (below). The various steps associated with the licence amendment process are described in more detail in two open letters published on Ofgem's website¹¹ and Chapter 4 of this document, and the indicative timetable is attached as Appendix 1.

¹¹ Ofgem open letters *Timetable for Potential Gas Distribution Network Sales* (16 July 2004) and *Licence Amendment Process* (5 August 2004). These documents are available on the gas distribution network sales page of Ofgem's website.

Table 1 Summary of way forward¹²

| | |
|--|---|
| Release of Transco's draft licences | Transco produces detailed licence drafts for the NTS and DNs (including RDNs and IDNs) in a form which reflects the proposed licence structure discussed in this informal consultation document and indicates many of the modifications which Ofgem will propose to introduce under the section 23 notice. These documents will be published on Ofgem's website in order to inform industry debate. |
| Grant of additional GT licences to Transco | Ofgem receives comments regarding Transco's application for new additional GT licences by 24 September. Subject to consideration of consultation responses, the new additional GT licences would then be granted to Transco. It is anticipated that, at this stage, the new licences will largely mirror Transco's existing GT licence. |
| Issue s23 notice | Ofgem issues a notice under section 23 of the Gas Act to formally modify each of Transco's GT licences (i.e. Transco's existing GT licence and, if granted, the new additional DN-GT licences). The notice would be consulted upon for 28 days. The notice will reflect Ofgem's consideration of views expressed in relation to this informal consultation document. |
| Amendment of licences | In the event that the Authority consents to a sale then, subject to consideration of responses, the Authority would issue directions to bring into effect the modifications to Transco's existing GT licence and, if granted, the new additional DN-GT licences. If respondents raise any significant issues, a further section 23 notice may need to be issued. |
| Issue consultation on transfer of licences to wholly owned Transco entities | Transco applies for the new DN-GT licences to be transferred to the DN companies that are wholly owned by Transco and there is a two month formal consultation under section 8AA the Gas Act relating to the transfer. Any issues that remain outstanding following the section 23 process may be addressed as part of the section 8AA process. |
| Transfer of licences | Subject to responses received in the section 8AA consultation process, the amended DN-GT licences are transferred to Transco's wholly owned DN companies. |
| Consent to sale of shares in DN companies to purchasers | It may be necessary to introduce further changes to Transco's existing GT licence and, if granted, the new additional DN-GT licences as part of the Authority's consent to Transco to dispose of the shares in the DN companies to third party purchasers. |

¹² Shading indicates that the step is subject to the outcome of the Authority decision on whether to consent to the proposed DN sales.

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1. Introduction

Purpose of this document

- 1.1. In May 2003, National Grid Transco plc (NGT) publicly announced that it would consider the sale of one or more of Transco plc's (Transco) local gas Distribution Networks (DNs) if it were to maximise shareholder value. Such a sale would represent a fundamental change to the structure of the gas industry. Any sale of DN assets by Transco would require the consent of the Gas and Electricity Markets Authority (the Authority), the Health and Safety Executive (HSE) and the Secretary of State for Trade and Industry (the Secretary of State).
- 1.2. As part of the process of the proposed disposal, in July 2004 Transco applied for eight new additional gas transporter (GT) licences relating to each of its DNs. Consultation on these applications is due to end on 24 September 2004¹³. Subject to the consideration of respondents' views, it is envisaged that at least five new additional GT licences will be granted to Transco to accommodate four potential independent DNs (IDNs) and Transco's retained DNs (RDNs). Ofgem has recently released a preliminary position paper on DN / DN separation¹⁴. Under the arrangements outlined in this preliminary paper, RDNs would be permitted to be governed by one licence. Similarly, if a potential purchaser acquired more than one DN, these DNs would also be permitted to be governed by one licence. It is envisaged that the new additional licences would (if granted), initially, largely mirror Transco's existing GT licence.
- 1.3. The purpose of this document is to consult upon modifications to Transco's existing GT licence and, if granted, each new additional GT licence, in the context of the proposed sale of one or more DNs by Transco. These modifications, both to the content and structure of the licences, would be required to ensure that the regulatory framework will be able to support the divested industry structure that would be in place should one or more DNs cease to be owned by Transco.

¹³ Notice of proposed grant and proposed modifications of eight new additional gas transporter licences, Ofgem, July 2004

¹⁴ Ofgem Preliminary Position on the Business Separation requirements to apply between Distribution Networks, Ofgem, August 2004

- 1.4. Given the commercial timetable for DN sales, it is essential that the Authority gives detailed consideration to the appropriate regulatory structure.
- Consideration of the ultimate form of licences to be held by Transco and any potential purchasers of DN in the event of DN sales does not fetter the discretion of the Authority regarding any decision it may have to make in respect of DN sales, including without limitation, any decision regarding the grant of the new additional GT licences.
- 1.5. This document gives a high-level outline of the issues surrounding each licence condition and Ofgem's initial view of the proposed licence structure. The document also includes initial views of proposed changes to licence conditions and outstanding issues.
- 1.6. It is important for respondents to be aware that aside from normal modifications to Transco's existing GT licence which will continue regardless of DN sales, Ofgem will review the need to modify Transco's existing GT licence and, if granted, the new additional GT licences as part of the DN sales process at three separate stages:
- ◆ the section 23 notice;
 - ◆ the section 8AA consent; and
 - ◆ as part of the consent to disposal of the relevant DN assets under the Amended Standard Condition 29 (Disposal of Assets) of Transco's existing GT licence. Transco will request consent to disposal of the relevant DN assets to new wholly-owned subsidiary companies (DN companies). Subject to the Authority's deliberation on this point, it is likely any such consent would be subject to, amongst other things, a condition requiring Transco to retain ownership of the shares of the new companies. Sometime later, Transco will ask the Authority for consent to the disposal of the shares to third party purchasers. It may be possible that some modifications to Transco's existing GT licence and, if granted, the new additional GT licences would be required as part of this process.
- 1.7. Ofgem has flagged in this document the various areas of the licences it expects it may seek to modify and the method of modification. However, this is an iterative process and the suggested modification points and suggested way

forward are not binding on the Authority. Ofgem's intention is, subject to resolution of policy issues and addressing any issues raised by respondents, to make as many of the changes as possible through the section 23 process. However, this may not be possible and may mean that some issues need to be addressed at the section 8AA stage as part of the consent to disposal.

- 1.8. While describing the initial modification proposals, this document does not set out Ofgem's final view on these proposals, but rather indicates a first assessment of these proposals at a high level. Ofgem will proceed to an in-depth revision of these proposals in due course.
- 1.9. This document does not constitute a formal licence modification consultation. A section 23 notice will be issued in early November 2004 and Ofgem is inviting views on this document in order to help inform the content of that notice and inform its thinking on the section 8AA process and the consent to disposal. In order to assist respondents, Transco will be providing first drafts of the proposed licences for the National Transmission System (NTS) and DNs (both RDNs and IDNs) within two weeks of publication of this document. Ofgem will advise respondents at the time of publication of these draft licences of the process to be followed if they wish to submit comments on these documents. These draft licences will be based on the structure set out in this document.
- 1.10. It is important to note that, subject to complying with the requirements of section 23 of the Gas Act 1986 as amended by the Utilities Act 2000 (the Gas Act) and having regard to representations or objections made and not withdrawn, in order to make a modification to the conditions of each of Transco's GT licences (i.e. Transco's existing GT licence and, if granted, the new additional GT licences) only Transco's consent will be required in accordance with the requirements of section 23(6) of the Gas Act as it will be the holder of the relevant licences at the relevant time. This means that only Transco will be asked to provide its consent to the modifications to its existing GT licence and to the new additional GT licences, if granted. This consent, if provided by Transco, would enable (but not oblige) the Authority to direct that that the modifications proposed under the section 23 notice can be made.
- 1.11. However, in light of the proposed sale of the DN businesses, Ofgem would particularly hope to receive comments on the proposed changes to the content

and structure of Transco's existing GT licence, and the new additional GT licences if granted, from, amongst others, potential DN purchasers in order to inform its thinking on the content of the section 23 notice and licence modifications which may be necessary in due course as part of the section 8AA process and the consent to the disposal of the shares in the DN companies.

- 1.12. As this proposed transaction is not a regulatory initiative but rather a commercial decision by Transco, Ofgem intends to modify those GT licences held (or to be held) by Transco only and not any other GTs. However, in identifying the proposed modifications, Ofgem has given careful consideration to the impact on other GTs and in particular has satisfied itself that no undue discrimination would be created through the proposals set out in this document. However, if any respondent considers that the proposed modifications would adversely impact on them, then Ofgem would welcome representations on this matter.
- 1.13. In issuing this document and describing the proposed regulatory process to be followed, it is important to make clear that there can be no expectation on the part of NGT, Transco, potential DN purchasers, shippers, suppliers, Independent Gas Transporters (IGTs) or any other interested parties either as to what the Authority's final decision in relation to the proposed transaction may be, or as to the regulatory framework which may be implemented if the Authority consents to the proposed transaction.
- 1.14. The information contained in this document is not binding on the Authority. Nothing in this document is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion in this matter will not be fettered by any statements made in this document.

Background to this document

- 1.15. Following Transco's announcement of the proposed sale in May 2003, in July 2003, Ofgem issued a consultation document on the regulatory, commercial and operational changes which would be required to facilitate any sale of one or more DNs.¹⁵ Following this consultation, in December 2003, Ofgem issued its

¹⁵ *National Grid Transco – Potential sale of network distribution businesses, A Consultation Document.* Ofgem, July 2003.

Next Steps document setting out responses to the July 2003 consultation, Ofgem's current views and a proposed way forward for considering NGT's proposals including the establishment of workgroups to take forward the development of a commercial and regulatory framework.¹⁶

- 1.16. Since the release of the December 2003 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 (AWG) to continue the proposed DN sales consultation process.
- 1.17. Each of these workgroups has met regularly since January 2004 (although issues which were initially being considered by the RAWG were more recently considered by the DISG). The workgroups have provided industry participants with an opportunity to contribute to the development of a commercial and regulatory framework that would support the sale of one or more DNs, should Transco obtain the necessary consents.
- 1.18. The discussions that have taken place during the workgroup process have highlighted the importance of a number of key issues to the development of a potential licensing framework. These include:
 - ◆ the allocation of roles and responsibilities between the NTS, IDNs and RDNs;
 - ◆ the development of appropriate governance and agency arrangements for shipper (and customer) interfaces, particularly focusing on supply point administration frameworks;
 - ◆ the development of code arrangements, in particular the form of a uniform network code (UNC);
 - ◆ the arrangements governing the interface between the NTS, DNs, shippers/suppliers and customers, in particular focusing on offtake and interruption arrangements frameworks; and

¹⁶ *National Grid Transco – Potential sale of network distribution businesses, Next Steps Ofgem, December 2003.*

- ◆ the degree of separation required between Transco's NTS business and the RDNs.

- 1.19. In light of these discussions Ofgem issued a way forward document in March 2004, indicating that it would be appropriate to develop for consultation separate Regulatory Impact Assessments (RIAs) on these issues.¹⁷ Ofgem considered that the release of these RIAs would be consistent with the Authority's duty to carry out impact assessments.¹⁸
- 1.20. In April 2004, Ofgem released two RIAs relating to the potential sale of one or more DNs. These assessed different options for both agency and governance arrangements, and the appropriate allocation of roles and responsibilities between the NTS, the RDNs and the IDNs, following the sale of one or more DNs.¹⁹ In May 2004, following a period of consultation, Ofgem released indicative conclusion documents in respect of both of these issues²⁰. In June 2004, Ofgem issued two RIAs relating to offtake and interruptions arrangements, followed by two indicative conclusions documents in August 2004²¹.
- 1.21. Ofgem also issued an open letter to industry participants setting out the regulatory timetable for Transco's sale of DNs on 16 July 2004²².

Structure of this document

- 1.22. This document is structured as follows:

- ◆ Chapter 2 sets out the regulatory framework that is relevant to the proposed sales;

¹⁷ *Potential sale of gas distribution networks, Ofgem update on way forward*, Ofgem, March 2004.

¹⁸ This duty is contained in section 5A of the Utilities Act 2000.

¹⁹ *National Grid Transco - Allocations of roles and responsibilities between transmission and distribution networks* Ofgem April 2004, and *National Grid Transco – Potential sale of gas distribution network businesses, Agency and Governance Arrangements* Ofgem April 2004

²⁰ *National Grid Transco – Potential sale of gas distribution network businesses, Allocation of roles and responsibilities between transmission and distribution networks, Conclusions* Ofgem, May 2004 and *National Grid Transco – Potential sale of gas distribution network businesses, Agency and Governance Arrangements, Conclusions* Ofgem, May 2004.

²¹ *National Grid Transco – Potential sale of gas distribution network businesses, Interruption arrangements, Conclusions document on framework*, Ofgem, August 2004 and *National Grid Transco – Potential sale of gas distribution network businesses, Offtake arrangements, Conclusions document on framework*, Ofgem, August 2004

²² Ofgem Open letter: Timetable for Potential Gas Distribution Network Sales Project. http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7883_timetable_letter_july04.pdf

- ◆ Chapter 3 describes the proposed structure of the licences to be established and the process for licence amendments;
- ◆ Chapter 4 sets out the key issues regarding changes to the licensing regime;
- ◆ Chapter 5 describes the licence conditions currently contained in Transco's existing GT licence, the proposed changes arising from any DN sales, the proposed form of any such changes and whether or not the conditions will apply to Transco's NTS, the DNs or both;
- ◆ Chapter 6 describes some of the new licence conditions that might be required; and
- ◆ Chapter 7 sets out Ofgem's proposed way forward.

Views invited

- 1.23. Ofgem welcomes views on this consultation document, to be received by close of business 29 September 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)

Electronic responses may be sent to tracey.hunt@ofgem.gov.uk

- 1.24. 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.
- 1.25. If you wish to discuss any aspect of this paper, Catherine Saponar (telephone 020 7901 7207) or Jessica Hunt (020 7901 7431) would be pleased to help.

Way forward

- 1.26. While this document addresses issues related to the licensing regime on a high level, further work on the detail of the licence modifications will be required.
- 1.27. A future RIA, encompassing the broader DN sales decision by the Authority, is being prepared by Ofgem and publication of this final RIA is intended for September 2004.
- 1.28. This document is the first step towards preparing a formal consultation under Section 23 of the Gas Act which Ofgem intends to publish in November 2004.

2. Regulatory framework

- 2.1. This Chapter sets out the regulatory framework that applies in the context of the proposed sale of one or more of Transco's DNs. This includes the key statutory duties on gas transporters (GTs) that need to be considered with respect to the development of the licensing regime necessary to support a potential DN sale and the sections of the Gas Act that provide for the licensing arrangements.
- 2.2. The description of the regulatory framework includes an outline of the current licence framework, including the current structure of Transco's existing GT licence. In addition, the Chapter also considers the objectives and duties that the Authority must fulfil when it decides whether to consent to the proposed DN sales.
- 2.3. This Chapter therefore outlines:
- ◆ the onshore regulatory framework; and
 - ◆ the regulatory approval process for DN sales.

The onshore regulatory framework

- 2.4. This section sets out the key elements of the regulatory framework that are relevant in the context of the proposed DN sale as follows:
- ◆ The Gas Act;
 - ◆ Transco's GT licence; and
 - ◆ The regulatory approval process for DN Sales.

The Gas Act

- 2.5. The Gas Act provides for the regulation of the onshore gas regime in Great Britain and for the separate licensing of GTs, gas shippers and gas suppliers. This section sets out the key relevant areas of the Gas Act for consideration.

Duties of the Authority

- 2.6. Section 4AA of the Gas Act provides that the principal objective of the Authority in carrying out its functions under the Gas Act is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate, by promoting effective competition between those engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas. In carrying out its functions under the Gas Act in a manner which is best calculated to further the principal objective, the Authority is required to have regard to the following:
- ◆ the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met; and
 - ◆ the need to secure that licence holders are able to finance the carrying on of the activities which they are authorised or required to do.
- 2.7. In performing such duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas (amongst other consumers).
- 2.8. The Authority may, in carrying out any of its functions, have regard to the interests of consumers in relation to electricity, telecommunications, and water and sewerage services, which are affected by the carrying out of those functions.
- 2.9. The Authority must carry out its functions in the manner it considers is best calculated to:
- ◆ promote efficiency and economy on the part of authorised persons and the efficient use of gas conveyed through pipes;
 - ◆ protect the public from dangers arising from the conveyance of gas through pipes or the use of such gas; and
 - ◆ secure a diverse and viable long term energy supply.

- 2.10. The Authority must also have regard to the effect on the environment of activities connected with the conveyance of gas through pipes.
- 2.11. In carrying out its functions in accordance with the above objectives and duties, the Authority must (once the relevant provisions of the Energy Act 2004 have been brought into force) have regard to:
- ◆ the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and
 - ◆ any other principles appearing to the Authority to represent the best regulatory practice.

Duties of Gas Transporters

- 2.12. In addition to meeting the Authority's statutory duties, the licence framework post DN sales must permit the NTS and DNs to fulfil their own statutory obligations under the Gas Act as GTs. These include:
- ◆ the duty of each GT to develop and maintain an efficient and economical pipeline system (section 9(1)(a) of the Gas Act);
 - ◆ the duty of each GT to facilitate competition in the supply of gas (section 9(1A) 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 (section 9(2)(b) of the Gas Act).

The licensing framework

- 2.13. Sections 5 to 8A of the Gas Act provide for the licensing of activities relating to gas. These include the licensing of GTs, gas shippers and gas suppliers. Section 7 of the Gas Act sets out the provisions relating to the licensing of GTs. Section 8 provides for Standard Conditions of licences.
- 2.14. Section 23 of the Gas Act sets out the provisions relating to the modification of licence conditions for which there are a number of different procedures. These are set out below:

- ◆ **Collective licence modification (CLM).** The CLM procedure deals with the modification of Standard Conditions under section 23(1)(b) and section 23(7) of the Gas Act. The Authority may bring forward proposals for licence modification and the CLM arrangements enable relevant licence holders who are not content with a proposed modification to a Standard Condition to register their formal objection. Numerical tests determine the level of objections to a proposal which is measured against a blocking minority threshold prescribed by the Secretary of State. In the absence of the blocking threshold being met, the Authority may direct that a proposed modification be made; and/or
- ◆ **Individual consent.** The individual consent process as set out in sections 23(1)(a) and 23(6) of the Gas Act requires the Authority to gain the consent of each relevant licensee prior to modification of the licence. This process can be used either in relation to amending Standard Conditions for individual licensees or for the introduction of new or amendment to existing Special Conditions for individual licensees. Where a Standard Condition has been modified by individual consent, it ceases to be subject to the CLM procedure to the extent that it has been modified.

2.15. In the absence of obtaining consent either through the CLM procedure or the individual consent of the relevant licensee, the Authority may refer the matter to the Competition Commission for resolution. The Gas Act provides the mechanism by which licences can be modified in the circumstances of such a reference.

2.16. Under section 8AA of the Gas Act a licence is capable of being transferred by the licence holder with the consent of the Authority, in accordance with the section, and any terms of the licence relating to its transfer. This may include conditions which must be complied with before the licence can be transferred. Consent may be given subject to compliance with such modification or other conditions as the Authority considers necessary.

Transco's existing GT licence

2.17. Transco is currently the holder of a GT licence issued under the provisions of the Gas Act. This covers the operation of its high pressure transportation business, largely the NTS, and its lower pressure distribution business largely on the DNs. It also applies to LNG storage arrangements and metering. Looking at the conditions in Transco's existing GT licence, it is clear that some relate to its:

- ◆ NTS operations;
- ◆ DNs operations; and
- ◆ both NTS and DN operations.

2.18. The licence currently has no distinction between conditions relating to the NTS and DNs. As such, it is clear that Transco's existing GT licence covers many aspects of its business on an integrated basis reflecting the fact that the NTS and DNs have been operated within a single legal entity and under one licence.

2.19. Currently, Transco's existing GT licence has three types of conditions²³. These are as follows:

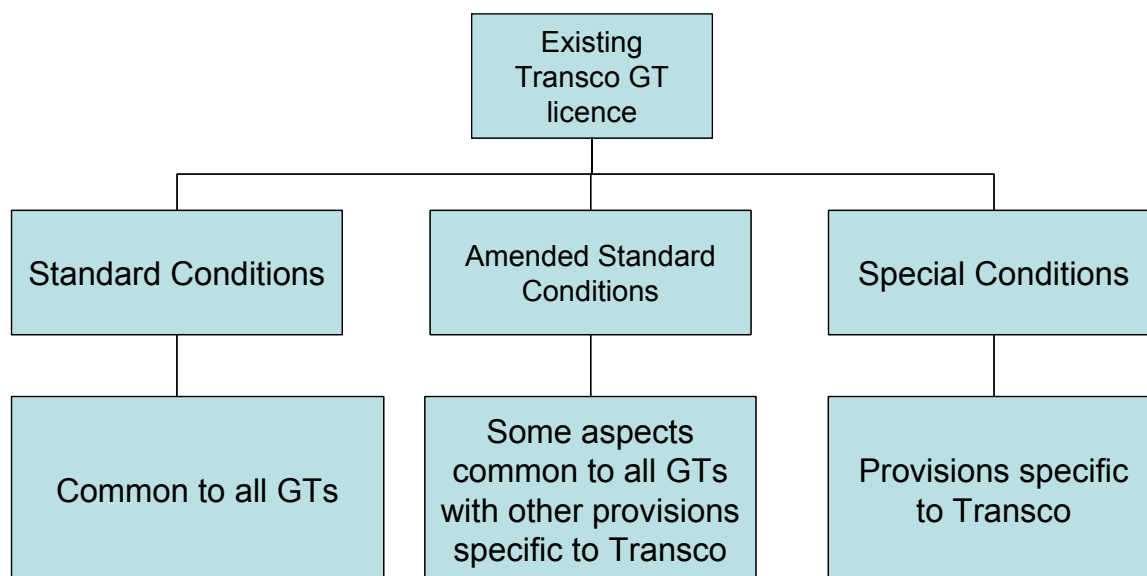
- ◆ **Standard Conditions.** These are applicable to all holders of GT licences unless otherwise modified or specified. These conditions were designated by the Secretary of State in September 2001 and have been updated by Ofgem since that time through the CLM procedure;
- ◆ **Amended Standard Conditions.** These are conditions where the wording of the Standard Condition has been amended with the consent of the relevant licensee (i.e. pursuant to sections 23(1)(a) and 23(6) of the Gas Act) to reflect a particular need or characteristic of the licensee. The amendments are not subject to the CLM procedure; and
- ◆ **Special Conditions.** These are specific to individual licensees and have been introduced with the relevant licensee's consent (i.e. pursuant to

²³ The Gas Act 1986 refers only to conditions or standard conditions – the terms Amended Standard Conditions and Special Conditions have been developed to differentiate between the types of conditions and the processes of modification applicable to them.

sections 23(1)(a) and 23(6) of the Gas Act) in order to reflect a particular need or characteristic of the licensee.

2.20. Figure 2.1 below illustrates the current structure of Transco's existing GT licence.

Figure 2.1: Configuration of Transco's existing GT licence



2.21. All Standard Conditions in GT licences are currently split into 3 sections, as follows:

- ◆ Section A of the Standard Conditions contains conditions relating to interpretation, application and payments;
- ◆ Section B of the Standard Conditions contains general provisions; and
- ◆ Section C of the Standard Conditions contains transport services obligations.

2.22. Conditions contained in Section C of the Standard Conditions are currently the only ones in the GT licence capable of being switched on or switched off (i.e. for the provisions to be active or not active over a particular period) by a direction of the Authority issued with the relevant licence holder's consent (pursuant to Standard Condition 2).

Regulatory approval process for DN Sales

- 2.23. In order to dispose of a DN asset, Transco will require the consent of the Authority in accordance with Amended Standard Condition 29 of Transco's GT licence²⁴. In deciding whether to give its 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.
- 2.24. The principal objective set out in section 4AA of the Gas Act as explained above relates to the protection of customers wherever appropriate by promoting effective competition. Having regard to the above objectives and duties, 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 the interests of present and future customers are protected.
- 2.25. Ofgem will need to consider each of its obligations and duties, in assessing the proposed modifications to each licence condition set out in Chapters 4 and 5.

²⁴ 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.

3. Restructuring Transco's GT licences

- 3.1. As outlined in the previous Chapter, Transco's existing GT licence currently provides the basis for the structure and functioning of both its NTS and DN activities which are currently operated on an integrated basis within its current licence. As explained earlier, as part of the proposal to divest one or more of its DN businesses, Transco has applied to Ofgem for eight new additional GT licences (which, if granted, will initially largely mirror the terms of Transco's existing GT licence). The potential sale of one or more of Transco's DNs will therefore mean that Transco's existing GT licence and, if granted, the new additional GT licences will need to be substantially amended and restructured to be appropriate for the gas transportation industry in a divested form.
- 3.2. The purpose of this Chapter is therefore to set out Ofgem's initial views on the proposed structure of Transco's existing GT licence and, if granted, the new additional GT licences going forward²⁵ in the event that one or more of Transco's DNs are sold.
- 3.3. This Chapter sets out:
- ◆ the number of GT licences that will be required in the event of DN sales;
 - ◆ regulatory issues associated with the proposed divestment;
 - ◆ the proposed structure of the amended licences; and
 - ◆ the proposed licence modification procedures.

Number of GT licences

- 3.4. As already noted, as part of its preparation for the proposed sale of one or more of its DN businesses, Transco has applied to Ofgem for eight new additional GT licences which, if granted, will initially largely mirror Transco's existing GT licence. At the time that Transco applies to the Authority for consent to dispose

²⁵ As explained in Chapter 1 the proposed licence modifications considered in this Chapter do not apply to holders of GT licences other than Transco.

of its DN businesses, it could therefore hold up to nine GT licences for its NTS and DN businesses.

- 3.5. Since Transco's application for the grant of the eight new additional GT licences, the Authority has stated that it is minded to require the legal separation of Transco's NTS and retained DN businesses (RDNs) in the event of a sale of one or more DNs. Ofgem has additionally set out its preliminary view²⁶ that DN businesses (whether RDNs or independent DNs (IDNs)) in the same ownership will not be required to be legally separate entities. Therefore a legal entity owning a number of DN businesses would only require one GT licence. Similarly, the legal entity that will own the RDNs will also only require one GT licence.
- 3.6. The number of licences that will be required for the IDNs will be dependent on the outcome of the proposed sale process. If Transco was to sell four DNs to four separate buyers, a GT licence would be required for each of the separately owned IDNs. If, however, Transco was to sell four DNs to a single entity then, like Transco's RDNs, only a single GT licence would be required for the legal entity which would acquire the four DNs. As indicated in the licence application notice the Authority intends to retain the right to revoke any new additional GT licences granted to Transco which are subsequently not required for the purposes of DN sales²⁷.
- 3.7. However, any GT licences which will be in place after the proposed divestment will have to provide an appropriate regime for the functioning of each of the different types of businesses to which they will apply and will need to be in a form which ensures that the regulatory regime is not undermined by virtue of the sale. Transco's existing GT licence and, if granted, the new additional GT licences will therefore need to be modified to accommodate the following:
- ◆ the NTS business;
 - ◆ the RDN business; and

²⁶ *Ofgem Preliminary position on the Business Separation requirements to apply between Distribution Networks*, Ofgem, August 2004.

²⁷ *Notice of proposed grant and proposed modifications of eight new additional gas transporter licences*, Ofgem, July 2004.

- ◆ IDN businesses.

This will include addressing issues such as where and how metering and LNG storage arrangements, currently regulated within Transco's licence, should be located and regulated in the future.

Regulatory issues arising from the changes to GT licences

3.8. Ofgem has conducted an initial analysis to assess which licence conditions in Transco's current GT licence would, in a divested industry structure, be appropriate to:

- ◆ transmission (to apply to the NTS);
- ◆ distribution (to apply to the RDNs and IDNs); and
- ◆ both transmission and distribution (to apply to the NTS, RDNs and IDNs).

3.9. Ofgem has additionally considered whether new licence conditions would need to be introduced to reflect a divested network structure and the treatment of metering and LNG storage arrangements going forward.

3.10. This preliminary analysis has concluded that a significant number of modifications would be required to Transco's existing GT licence and, if granted, the new additional GT licences in order to address the regulatory issues associated with the sale of one or more DNs. This is a direct consequence of the currently integrated nature²⁸ of Transco's business which is reflected in its current GT licence.

3.11. The most significant impact of these (potentially extensive) modifications would be that the current Standard Conditions would, in the main, need to become Amended Standard Conditions in order to reflect the issues raised by the proposed sale. In turn, this would mean that the statutory CLM procedure,

²⁸ Transco's existing licence covers a number of different activities including: transmission; distribution; LNG storage; and metering.

contained in the Gas Act, would cease to apply to the Standard Conditions to the extent that they are modified. Given the potential scale of the modifications, Ofgem considers that this would, in practice, make the statutory CLM procedure largely unavailable.

- 3.12. The statutory CLM procedure provides the Authority with the ability to modify Standard Conditions across a class of licences without requiring the consent of every holder of such licences. Ofgem considers that to lose the ability to consistently modify GT licences in a divested network structure would not be in the interests of customers nor would it be consistent with its new duty to have regard to best regulatory practice.
- 3.13. In the absence of such a CLM procedure, whenever Ofgem proposed a modification to a Standard Condition of a NTS or DN-GT licence, it would need to obtain the individual consent of each licence holder. In the event that such consent was not forthcoming, Ofgem would either:
- ◆ need to refer the proposed modification to the Competition Commission for determination;
 - ◆ not proceed with the proposed modification; or
 - ◆ direct that only the consenting licence holders' licences be modified.
- 3.14. Ofgem considers that there is a risk that this arrangement could result in Transco's existing GT licence and, if granted, the new additional GT licences diverging and becoming inconsistent with other licences which would potentially cause detriment to customers. As such, Transco's existing GT licence and, if granted, the new additional GT licences must be developed to ensure that the Authority continues to have the ability, where appropriate, to modify conditions collectively to ensure that its regulatory control is not reduced as a result of the proposed transaction.
- 3.15. As such, Ofgem is proposing to create a procedure equivalent to the current statutory CLM procedure. This "private" CLM procedure would be incorporated into the licence conditions in Transco's existing GT licence and, if granted, the new additional GT licences. It would apply to certain conditions in the GT licences of the NTS, the RDN and IDNs which, in their revised format, Ofgem

considers to be, and should remain common to a number of licensees. This would allow those conditions to be collectively modified as if they were Standard Conditions. Such conditions are referred to in this document as the “Standard Special Conditions”²⁹.

- 3.16. Therefore, these Standard Special Conditions would be capable of being modified uniformly in order to continue to have the regulatory benefits and administrative certainty of Standard Conditions. The detail of the structure of the revised conditions is considered further in paragraph 3.26 below.
- 3.17. Ofgem would welcome respondents’ views on the proposed private CLM procedure. In particular, views would be helpful on:
- ◆ whether the percentage threshold in this procedure should be 20% or a different amount;
 - ◆ whether the basis for calculating market share should be relevant quantities of gas conveyed by the networks (as in the CLM order for gas transporters), numbers of metering points on networks (as in the CLM order for electricity distributions), or some other approach; and
 - ◆ whether, in addition, a test based on numbers of licences is warranted, and if it whether this should reflect (in relevant circumstances) how many of the licensees of the eight DN areas are content.

Structure of the amended licences

- 3.18. Having established that a private CLM process would be necessary, Ofgem has considered what impact this would have on other conditions of the GT licences. In considering the appropriate regulatory structure of the GT licences, Ofgem is of the view that, where possible, it would be undesirable to allow Amended Standard Conditions to remain in place in Transco’s existing GT licence and, if granted, the new additional GT licences. As indicated above, the statutory CLM procedure does not apply to Standard Conditions to the extent that they have been amended. As some elements of these conditions in Transco’s GT licence are amended from the original Standard Conditions designated by the Secretary

²⁹ This private CLM procedure would be introduced pursuant to section 7B(7)(b) of the Gas Act.
NGT – Potential sale of gas distribution network businesses

of State, it is not possible for the Authority to apply fully the current collective licence modification procedure when seeking to modify them. As already noted, in Ofgem's view, this is undesirable as it reduces the extent of regulatory control over the licensees and increases the likelihood of unnecessary divergence between licences of the same class.

- 3.19. Therefore, Ofgem would (where possible) seek to revert the Amended Standard Conditions (and certain Special Conditions) in Transco's existing GT licence and, if granted, the new additional GT licences to the Standard Conditions designated by the Secretary of State, as updated by Ofgem pursuant to the statutory CLM procedure. However, this may not be appropriate in every case and, where a modification is required to a Standard Condition, instead of using an Amended Standard Condition at this time, Ofgem proposes to repeat the relevant Standard Condition (with the necessary amendments) as a Standard Special Condition which would be subject to the private CLM procedure. This would mean that Transco and the owners of the DNs would be subject to two similar conditions in respect of the same issue. It will therefore be necessary as part of the process for modifying Transco's GT licences, to "switch off" those Standard Conditions that have been replaced by Standard Special Conditions.
- 3.20. Standard Conditions in all GT licences are currently split into 3 sections, section C of the Standard Conditions of the GT licence is already capable of being switched on or switched off under Standard Condition 2. Ofgem would propose, pursuant to section 7(B)(7)(a) of the Gas Act, to introduce a new Standard Special Condition enabling the Authority to switch on or switch off Standard Conditions in sections A and B, with the consent of the licence holder. As with Standard Condition 2, this switch would be capable of being used in relation to entire conditions or parts of conditions and would not be time limited, enabling it to be used in the future³⁰.
- 3.21. In relation to this proposed new Standard Special Condition, Ofgem has considered whether it raises any form of undue discrimination particularly as regards other holders of GT licences. Having carefully considered the matter, Ofgem is satisfied that, as the condition would be introduced in order to allow

³⁰ Ofgem is satisfied that the introduction of this switch and the use of it in the context of DN sales would not cause any undue discrimination against IGTs (who would not have such a switch in their licences).

the private CLM procedure where it would otherwise not be available due to the extent of the proposed modifications and this would be necessary in order to maintain regulatory overview of the divested industry structure, there is no issue of discrimination. Ofgem would intend to use this power to switch on and off Standard Conditions in order to deal with any regulatory issues associated with DN sales now or in the future. Ofgem would welcome views on this issue.

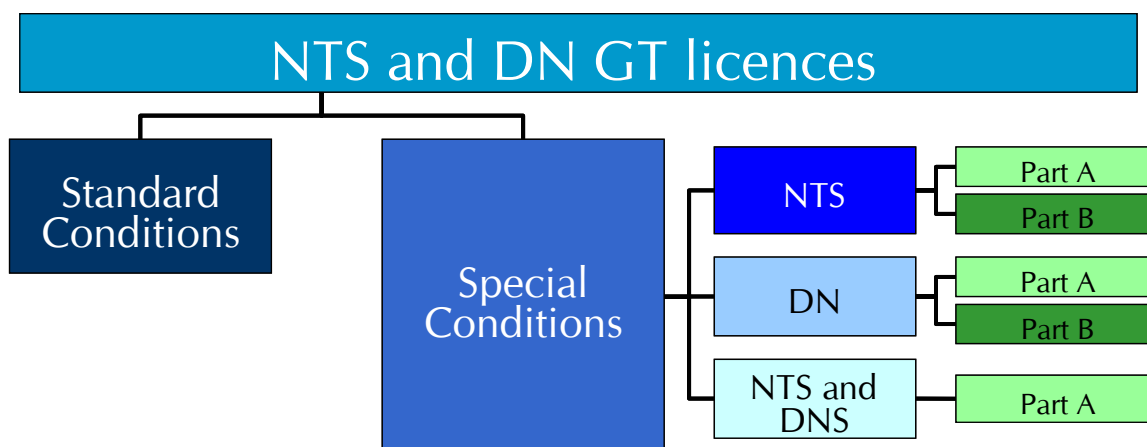
3.22. The remainder of this section therefore sets out:

- ◆ the proposed structure of the NTS and DN-GT licences;
- ◆ the proposed modifications process of the NTS and DN-GT licences; and
- ◆ the mechanics of the section 23 notice.

Proposed structure of NTS and DN-GT licences

3.23. Based on the regulatory changes set out above, Figure 3.1 illustrates Ofgem's initial view on the proposed ultimate structure of Transco's existing GT licence and, if granted, each new additional GT licence.

Figure 3.1: Proposed GT licence structure



3.24. Ofgem's initial view is that the GT licences for the NTS and DNs will comprise of:

- ◆ ***Standard Conditions.*** These conditions would be common to, but not necessarily operative in the licences of all NTS and DN-GTs (as certain Standard Conditions would be switched off and repeated in a modified

form as Special Standard Conditions and certain conditions may apply to the NTS and DNs only);

- ◆ ***Special Conditions applicable to transmission only.*** These conditions would be split into two parts:
 - ◆ Part A would comprise Standard Special Conditions common or standard to NTS businesses (although it is acknowledged that, in practice, there will be only one NTS on day one post DN sales); and
 - ◆ Part B would comprise Special Conditions unique to individual licensees (i.e. unique to the NTS).
- ◆ ***Special Conditions applicable to the distribution businesses (i.e. IDNs and RDNs) only.*** Once again, these conditions would be split into two parts:
 - ◆ Part A would comprise Standard Special Conditions common to all DNs; and
 - ◆ Part B would comprise Special Conditions unique to individual DNs.
- ◆ ***Special Conditions applicable to both NTS and DNs.*** These would be those Standard Special Conditions common to both NTS and DN activities. There would be no purely Special Conditions for this section as any required Special Conditions would be dealt with in the transmission or distribution sections as appropriate.

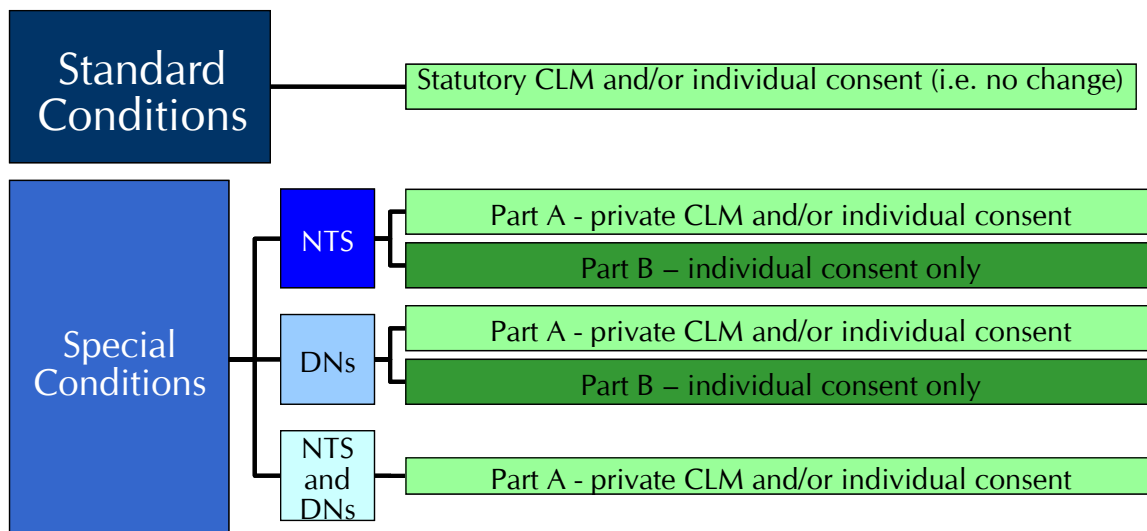
3.25. Ofgem invites respondents' views on the proposed structure of the amended licences.

Proposed licence modification procedures

3.26. Under the structure of the NTS and DN-GT licences set out above, different arrangements would exist for the modification of specific conditions within the licence (depending on the specific section of the licence in which the condition

is located). The proposed modification arrangements are set out in the diagram below:

Figure 3.2: Proposed modification arrangements



3.27. In summary, the modification procedure for Special Conditions would work as follows:

- ◆ **Part A** would contain the Standard Special Conditions which would be subject to the private CLM and/or the individual consent of the licensee where appropriate (as with current Standard Conditions). As can be seen from the diagram, each of the NTS, DN and combined NTS and DN sections would have a Part A; and
- ◆ **Part B** would contain the rest of the Special Conditions which would not be subject to the private CLM procedure and would only be capable of being modified with the individual consent of the licensee as is currently the case with Special Conditions.

3.28. Ofgem is still considering exactly which licence conditions would fall within each part. In using this structure and modification process, Ofgem's intention is, as far as is practicable and appropriate, to replicate the existing structure of the licence as it exists today and to ensure consistency of modifications. The aim is largely to ensure that Ofgem's regulatory control is not diminished as a result of the proposed transaction. Ofgem is still considering whether, in introducing the private CLM procedure, it would be appropriate to continue to follow the voting

thresholds which are currently prescribed for the purposes of the statutory CLM procedure.

Mechanics of the section 23 notice

3.29. It is envisaged that the licence modification process to achieve this structure would be to issue a section 23(1)(a) notice in relation to Transco's existing GT licence and, if granted, the new additional GT licences (one notice but probably in separate parts to allow for separate directions). The process would be as follows:

- ◆ The new Standard Special Conditions required to replace certain existing Standard Conditions would be proposed for the relevant sections of Transco's existing GT licence. This would mean that Transco would be subject (momentarily) to two similar licence obligations (i.e. the new Standard Special Conditions and the Standard Conditions);
- ◆ There would be a modification to remove the amended parts of the existing Amended Standard Conditions as these would be redundant and these provisions would then revert to the relevant Standard Conditions³¹ once the direction to modify was issued;
- ◆ Any new conditions which are required would be proposed; and
- ◆ Once the new condition allowing Ofgem to switch off conditions in Parts A and B (equivalent to Standard Condition 2) has been introduced (as discussed in paragraph 3.20 above) and the new Special Conditions are introduced into the licences under the relevant direction to modify, Ofgem would switch off the relevant Standard Conditions by issuing a direction with the consent of the licensee.

³¹ By removing the modification – assuming the condition is taken back to the then current version of the standard (as designated by the Secretary of State and updated by Ofgem pursuant to the statutory CLM procedure) - it will become a standard again and is capable of being modified by the statutory CLM or by individual consent under section 23.

4. Key issues

4.1. This Chapter sets out some of the key issues regarding changes to the licensing regime that would be required in the event that DN sales proceeds. The key issues include:

- ◆ transportation charging arrangements;
- ◆ the provision of emergency services;
- ◆ system operator managed service arrangements (SOMSAs);
- ◆ network code/UNC and offtake arrangements;
- ◆ price controls and incentives; and
- ◆ pipeline security standards.

4.2. These key issues are based on the information that has been revealed so far in the process, largely through the industry workgroups. As these workgroups are ongoing, new issues may arise that will require consideration later in the licence development process. We discuss each in turn below.

Transportation charging arrangements

4.3. The workgroups have considered the arrangements for transportation charging in a divested industry structure. During this process, two key concerns arose over the future arrangements. These were that the change in ownership of some of the DNs might:

- ◆ bring about differences in the way in which owners of the networks calculate charges for users of their networks. In the view of the workgroups, this might create additional complexity and costs for shippers; and
- ◆ cause distribution charges to be updated more frequently as different owners of the networks could choose to update their charges at a number of times throughout the year. An uncoordinated approach to charging and charging methodology changes could impose additional

costs on shippers because an increase in the frequency of changes in use of system tariff changes is likely to lead to shippers' systems needing to be updated more frequently.

4.4. Ofgem has considered these concerns and has decided that:

- ◆ to mitigate the risk of inefficient fragmentation of the methodology for distribution charging arrangements, the Joint Office (JO) should have responsibility for managing modifications to the distribution charging arrangements. By ensuring that the development of charging methodologies is co-ordinated across the industry, Ofgem considers that the risks of divergent charging arrangements developing are further limited. However, this does not preclude the development of different charging methodologies should the Authority consider it appropriate; and
- ◆ to limit the frequency of changes to use of system charges, Ofgem considers that GTs should be obliged to use reasonable endeavours to announce changes to these charges on one specific date each year. Nonetheless, this obligation would recognise that it may, on occasion, be necessary for GTs to change their charges more frequently than annually.

4.5. Given these views, Ofgem believe that it will be necessary to modify extensively Amended Standard Conditions 4 and 4A, of Transco's existing GT licence which currently set out the licence obligations regarding Transco's use of system charging arrangements.

4.6. Ofgem invites views on these proposed amendments.

Emergency services coordination

4.7. The workgroups have discussed issues regarding emergency service co-ordination that arise from a change in ownership of some of the DNs. This has three key aspects:

- ◆ emergencies at DN boundaries;
- ◆ emergency services provision to IGTs; and

- ◆ emergency service provision from the DNs to the NTS.

4.8. We discuss each in turn and invite views on all of the points raised.

DN boundaries

- 4.9. One concern, given the potential change in ownership of some DNs, is that, on occasion, it will not be possible to determine on which network an emergency has arisen at the time the incident is reported (to Transco through the emergency number)³². For instance, if an emergency is reported close to a network boundary, it might not be possible for Transco to determine which DN network the incident has arisen on and, therefore, which DN to notify regarding the incident.
- 4.10. To deal with these cases, Ofgem would like to invite views on whether it will be necessary to ensure that the licence condition relating to emergencies ensures that whichever DN is notified of the incident and despatches an engineer to it is obliged to make safe the incident regardless of the network on which it transpires that the incident has actually occurred on.
- 4.11. Ofgem also invites views on the treatment of liabilities associated with the potential obligation to make safe an incident regardless of the ownership of the network.

First response emergency services to IGTs

- 4.12. Currently, if directed to do so by the Authority in terms of Special Condition 19, Transco must offer to enter into an agreement with other GTs for the provision of emergency services where a major loss of supply has occurred under the provisions of Special Condition 19. Special Condition 19 ensures that Transco charges the IGTs for these services at a “reasonable rate”. Ofgem has received representations from several industry participants expressing concern that the current arrangements will no longer be workable under a divested industry structure and that, instead, it will be more appropriate to place a licence

³² Transco’s statutory role in providing a central emergency response number is also recognised in the Gas Safety (Management) Regulations 1966 S.I. No 551

obligation on all DN-GTs to continue to provide emergency services to all IGTs at a reasonable rate.

- 4.13. Ofgem would like to invite views on whether to place a licence condition upon the DN-GTs that obliges them to make available to IGTs only those services considered to be monopoly emergency services, rather than those that might be considered to be available on a commercial basis (such as ongoing repair and restoration services).

First response emergency services to NTS

- 4.14. Currently, Transco responds to incidents on the NTS using the workforce of the DN in which the incident occurs. Transco have suggested in workgroup discussions that it would not be efficient for the NTS to provide its own emergency response workforce given the infrequency of incidents on the NTS and the need to respond to any incident within one hour. For this reason, Transco has suggested that it would be appropriate for the DN-GTs to be obligated under the terms of their licences to provide first response emergency services to the NTS-GT at a reasonable rate.

- 4.15. Ofgem is considering this issue and welcomes respondents' views.

System operator managed services agreements

- 4.16. Given the timescales associated with the proposed transaction, Transco intends to put in place a number of network service agreements (NSAs) between DNs and the NTS following the sale of the DNs. This will allow many of the services that are currently undertaken by the NTS on behalf of DNs to continue following any DN sales. These NSAs cover a number of functions including system operation and front office.
- 4.17. The workgroups have considered whether it would be appropriate to regulate the NSAs. A particular issue that the workgroups have considered is whether System operator managed service agreements (SOMSAs) should be regulated by Ofgem.
- 4.18. SOMSAs will be arrangements between Transco's NTS-GT and the DN-GTs that provide for Transco to undertake system operation on behalf of DN-GTs.

SOMSAs are intended to be interim measures only to account for the fact that it will not be possible for the DN owners to establish their own system operation facilities for Day 1 of ownership. The agreements are not, however, intended to be enduring agreements and it is anticipated that DNs will establish their own SO facilities in the medium term.

4.19. Some members of the workgroup have put forward the view that these SOMSAs should be regulated. However, Ofgem's initial view as put forward in the workgroups is that these agreements should be unregulated because:

- ◆ the current price control arrangements ensure that customers are protected from payments recovered by Transco from DN-GTs under the SOMSA;
- ◆ the charges and liabilities arising from the SOMSA should impact on the price that buyers are prepared to pay for the networks. Therefore, for the duration of this price control, the financial flows under the SOMSA from the DNs to Transco and the price paid for the network by new DN owners to Transco should net off so that there is no net financial gain by either party in the transaction; and
- ◆ regulation of the SOMSA may tend to perpetuate the arrangements. Ofgem's Roles and Responsibilities RIA concluded that it was appropriate for the DN owners to be responsible for the operation of their networks. As discussed, in the short term the DNs will discharge this responsibility through the SOMSA. However, in the medium term, it is envisaged that DN-GTs undertake their own system operation activities in line with their responsibilities. Ofgem is concerned that, were the SOMSA to be regulated, it may encourage these arrangements to persist longer than is desirable.

4.20. Ofgem invites views on its proposal not to regulate the SOMSA.

Network Code and offtake arrangements

4.21. To facilitate DN Sales it will be necessary to change extensively the Network Code to reflect the revised commercial arrangements that will accompany any DN disposal. Having discussed this issue extensively at workgroups, Ofgem's

initial view is that the current Network Code will be replaced by a Uniform Network Code (UNC) and Short Form Network Codes specific to each DN that reference the UNC.

4.22. Furthermore, the Agency RIA concluded that the modification process for the UNC shall be managed by the Joint Office. Ofgem and the workgroups considered that the establishment of the Joint Office would mitigate the potential for undue discrimination in the process of modifying the UNC (and Short Form Network Codes). As a result, Amended Standard Condition 9 of Transco's licence will need to be amended so that the NTS-GT and DN-GT licences reflect these changes.

4.23. The Offtake Arrangements RIA concluded that, to prevent undue discrimination, it was appropriate that the UNC and the offtake arrangements were governed by a common set of governance arrangements. However, the relationship between the offtake code and the UNC is still for consideration. Two options are currently being considered. These are:

- ◆ **the UNC only approach.** Under this approach, the commercial aspects of the offtake arrangements would be integrated into the UNC. This would mean that the commercial arrangements for the offtake of gas from the NTS by DNs and large customers connected directly to the NTS would be incorporated within the UNC; or
- ◆ **Transco preferred approach of UNC plus offtake code.** Under this approach, the provisions of the UNC and those of the offtake arrangements would be in separate agreements with a single set of overarching governance arrangements that apply to both agreements. Therefore, although the governance arrangements would be same, the treatment of NTS offtakes would be under a different set of arrangements to those of the rest of the commercial arrangements.

4.24. Further work is required to analyse the regulatory issues with these options, including the implications of potential exemptions from the Gas Act. In either case, Amended Standard Conditions 4E and 9 will need to be modified accordingly. Ofgem invites views on each of these approaches.

Price controls and incentive arrangements

- 4.25. The separation of Transco's licence into NTS-GT and DN-GT licences will mean that the current price control arrangements (including incentives) for each DN will need to be appropriately reflected in the DN-GT licences applicable to the DN in question.
- 4.26. Ofgem has concluded³³ that it would not be appropriate to reopen Transco's price control on account of the sale of one of more DNs. However, the Offtake Arrangements RIA and the Interruptions RIA concluded that it will be appropriate to place incentives on the DN-GTs to encourage accurate investment decisions by DNs. Thus, DN-GT licences will need to incorporate these incentives arrangements.
- 4.27. Given representations by a number of interested parties on the likely form, scope and duration of the incentive scheme, Ofgem has responded by publishing a position paper³⁴ that indicated that, initially, the duration of the scheme for the DNs would be of one year only. It did not, however, comment on the form and scope of any DN incentive scheme.
- 4.28. Ofgem considers that these incentive arrangements will be supplemental to the price control. Ofgem proposes to consider these issues in detail in a separate consultation document intended for publication in November 2004.

³³ *Open letter on Gas Distribution Price Controls*, Ofgem, March 2004

³⁴ *Ofgem preliminary position on duration of incentives*, Ofgem, August 2004

- 4.29. A further issue for consideration in this respect is the approach to offtake arrangements. In the Authority's decision on the Offtake RIA two potential approaches were outlined. These approaches would have different effects on the financial flows under the price controls between the NTS and DNs. Ofgem intends to progress this issue through the workgroup process in the coming weeks.
- 4.30. A final issue with respect to the price control is that the Authority decided in April of this year to introduce the concept of a "safety net"³⁵. This is designed to protect customers by reducing Transco's NTS allowed revenue to cover the costs of DN Sales, if only one comparator emerged from the sales process. While the final value of the safety net is yet to be determined, clearly, if only one comparator was to emerge from the DN Sales process, then the NTS price control would be adjusted by the pre-determined amount of the safety net.
- 4.31. Ofgem invites views on all of the price control issues raised in this section.

Pipeline security standards

- 4.32. Standard Condition 16 of Transco's existing licence places obligations on it to develop the pipeline system to meet the peak daily demand for gas such that the ability of the pipeline system to meet that demand is only expected to be exceeded in 1 year out of 20 based on the previous 50 years of data (the 1 in 20 obligation).
- 4.33. Ofgem invites views on whether this security standard should continue to apply to both the NTS and the DNs and hence that future licence conditions should apply to both NTS-GT licences and DN-GT licences.

³⁵ Ofgem's work on NGT's proposed gas network sale moves to next phase, Ofgem press release, 16 April 2004

5. Licence conditions

5.1. In this Chapter we set out a brief description of each licence condition in Transco's current GT licence as at the date of publication. This Chapter additionally provides a high level view of the changes that are likely to be necessary for each licence condition (if any) and indicates the type of condition it may be in the future (as outlined in Chapter 3). Where possible, Ofgem has sought to identify whether the proposed amendments are currently expected to be effected under either:

- ◆ the initial modification process under section 23 which will restructure Transco's existing GT licence, and, if granted, the 8 new additional GT licences, which will be held by Transco in preparation for the hive-down of the DN assets into separate wholly owned Transco subsidiary companies (the DN companies); or
- ◆ the subsequent modification process as part of the section 8AA transfer of the DN-GT licences from Transco to the DN companies which may make further amendments to the NTS and DN GT licences which will be held by Transco in preparation for transfer³⁶.

This Chapter follows the format of Transco's existing GT licence, and therefore sets out the proposed changes (if any) at a high level to:

- ◆ Standard Conditions³⁷ (Part A, Part B, and Part C of Transco's existing GT licence); and
- ◆ Special Conditions.

The conditions currently described in Transco's current GT licence as "not used" are not discussed in this Chapter nor are any proposed or pending modifications to Transco's existing GT licence.

5.2. As this is the first informal consultation on these issues, it is likely that Ofgem will subsequently, following full consideration of all respondents' views, revise

³⁶ We have not identified in detail in this document what matters may fall to be considered at the consent to disposal stage under Amended Standard Condition 29.

the scope and content of the proposed modifications of specific licence conditions. It is also important to note that the policy issues associated with the ultimate form of the NTS and DN-GT licences will continue to evolve between now and the issue of the section 23 notice and may be further refined as part of the section 8AA licence transfer process and as part of the consent to disposal under amended Standard Condition 29. Further, it should be noted that Transco's existing GT licence will continue to be subject to review and modification by the Authority and will continue to be so modified while this transaction progresses.

- 5.3. In order to assist respondents in commenting on the issues relating to the proposed modifications, Ofgem has set out in this Chapter a high level overview of Transco's existing GT licence as it largely exists today.
- 5.4. This Chapter does not purport to contain an accurate or complete summary of each and every issue addressed in each condition currently contained in Transco's existing GT licence. Furthermore, this Chapter does not try to narrate the custom, practice and convention regarding the interpretation of certain conditions currently in Transco's existing GT licence.
- 5.5. This Chapter is a high level summary of certain key issues only. It is not intended to be comprehensive. It is designed to give a flavour of some of the types of obligations the NTS and the DNs may be under should the proposed transaction proceeds. This document does not replace the section 23 modification process but rather is designed to allow respondents an opportunity to comment on the proposed modifications in advance. It should also be noted that further changes may be included at the section 23 notice to reflect housekeeping changes which are necessary due to the extent of the modifications such as changing references to conditions.
- 5.6. As explained earlier in this document, the proposed transaction is not a regulatory initiative but a commercial decision taken by Transco. Accordingly, for the avoidance of doubt the proposed modifications included in this Chapter will not apply to GT licences held by IGTs and will apply only to Transco's existing GT licence, and if granted, the 8 additional new GT licences.

- 5.7. Pursuant to the Gas Act, the Authority maintains a register of all modifications made to Transco's existing GT licence. The register is open to the public. In order to assist respondents, Transco has agreed to the publication of a composite copy of its existing GT licence which it has prepared. The composite copy of Transco's existing GT licence as at 12 July 2004 has been published in conjunction with this document. A copy of this composite licence has been published today and can be found on Ofgem's website with this document. The Authority takes no responsibility for the accuracy or completeness of the composite copy of Transco's existing GT licence. Interested parties rely on the composite copy of Transco's existing licence at their own risk.
- 5.8. For the avoidance of doubt, the Authority is not offering or accepting any duty of care to respondents (including without limitation Transco, NGT, gas shippers, suppliers and IGTs and/or any potential purchasers of the DNs now or in the future) who base their responses on the summaries of the conditions contained in this Chapter. Respondents are reminded that it is incumbent on them to seek their own legal advice and to consider the actual text of Transco's existing GT licence before submitting responses which will inform the Authority's decision making process.
- 5.9. In issuing this document and describing the proposed regulatory process to be followed and in setting out a summary of certain licence conditions as currently contained in Transco's existing GT licence and details of the proposed future treatment of certain conditions, it is important to make clear that there can be no expectation on the part of NGT, Transco, potential DN purchasers, shippers, suppliers, IGTs or any other interested parties either as to what the Authority's final decision in relation to the proposed transaction may be, or as to the regulatory framework which may be implemented if the Authority consents to the proposed transaction.
- 5.10. Finally, as explained earlier in Chapter 3, it is Ofgem's policy preference to avoid using Amended Standard Conditions as part of this process. As such, Ofgem plans to propose modifications to Transco's existing GT licence, and, if granted, the 8 new additional GT licences, to revert to the Secretary of State designated version of the Standard Conditions for GTs as updated by the Authority pursuant to the CLM procedure. Where some departure from the Standard Condition is considered necessary, for the purposes of this transaction,

this is proposed to be done by way of a Special Condition or Standard Special Condition (in which case, it will be subject to modification pursuant to the private CLM procedure which Ofgem plans to introduce in addition to modification by consent). This means that where some amendment from the Standard Conditions is required to Transco's existing GT licence, and, if granted, to the 8 new additional GT licences, Ofgem will:

- ◆ propose a modification to revert to the Standard Condition;
- ◆ propose any new condition which is considered necessary; and
- ◆ once introduced and where appropriate, would then switch off the relevant Standard Condition.

5.11. While this may seem cumbersome, Ofgem considers this to be for the reasons set out in Chapter 3. All references to proposed modifications to Standard Conditions or Amended Standard Conditions should be read in this context.

Standard Conditions

Part A

Amended Standard Condition 1 – Definitions and interpretation

Description

5.12. This condition explains and defines the key terms employed within the licence unless the context otherwise requires. For example, some licence conditions contain definitions and interpretation that are specific to those licence conditions.

Proposed changes

5.13. Ofgem proposes to modify Transco's existing GT licence to revert to the terms of the Standard Condition, as designated by the Secretary of State as updated by the Authority through the CLM procedure. The intention is that the Standard Condition will apply to all NTS and DN-GT licence holders. However, where the context requires a different or additional definition; it is proposed that

definitions will be included in the licence conditions either as a Special Condition or a Standard Special Condition as appropriate.

- 5.14. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.15. Ofgem welcomes respondents' views on its proposal that Amended Standard Condition 1 will revert to the Standard Condition and to address any variations in the form of Special Conditions or Standard Special Conditions.

Standard Condition 2 – Application of Section C (transportation services obligations)

Description

- 5.16. This Standard Condition establishes the circumstances under which section C of the Standard Conditions of a GT licence will have effect either in whole or in part, with the consent of the relevant licence holder. Further provisions in this condition set out the process under Schedule 7 of the Utilities Act 2000, pursuant to which it was possible to switch conditions in section C on or off via a licensing scheme made by the Secretary of State.

Proposed changes

- 5.17. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 2 will continue to apply to all GT licences including NTS and DN GTs.
- 5.18. As set out in Chapter 3 of this document, Ofgem does however intend to introduce as a Standard Special Condition a licence condition similar to Standard Condition 2 that will apply to sections A and B of the Standard Conditions of the NTS-GT and DN-GT licences and which will enable Ofgem to switch on or off Standard Conditions in these licences.
- 5.19. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 2.

Standard Condition 3 – Payments by the Licensee to the Authority

Description

- 5.20. Standard Condition 3 sets out the obligation to pay to the Authority an amount determined in accordance with the Condition. It prescribes the relevant proportion of the costs of the Authority, Consumer Council, Competition Commission and Secretary of State that are attributable to the licensee and are therefore payable by it. It defines the timing of payment instalments as well as events of default. It also prescribes the form of certificate to be delivered in relation to the information provided by the licensee to the Authority for the purposes of enabling the Authority to calculate the licence fee payable by the licensee.

Proposed changes

- 5.21. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 3 will continue to apply to all GT licences, including NTS and DN GTs.
- 5.22. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 3.

Part B

Amended Standard Condition 4 – Charging Gas Shippers - General

Description

- 5.23. Amended Standard Condition 4 sets out a requirement on the licensee to produce charging statements and charging methodologies. In particular, it obliges the licensee to provide the Authority with:
- ◆ a statement of gas transportation charges;
 - ◆ the reserve prices of any auctions; and
 - ◆ provide information on the methods by which charges are determined under the licensee's charging methodology.

- 5.24. In the event of proposals by the licensee to change the transportation charges, 150 days' notice is required to be provided to the Authority with the estimated effect of the changes and the proposed implementation date. The licensee is also obliged to avoid any undue preference or discrimination in relation to the terms on which it enters into LNG Storage arrangements. The Authority can, in respect of LNG Storage arrangements, review the charges to determine whether any unjustified cross-subsidy exists.
- 5.25. The condition also makes provision for the publication and updating of the licensees' charging statements and methodology.

Proposed changes

- 5.26. As part of the workgroup process, a number of participants have raised concerns on the impact that DN sales will have on changes to charges and charging methodologies. In particular, workgroup participants were concerned that Independent Distribution Networks (IDNs) may wish to change their charges more frequently than Transco has done historically and additionally were concerned that changes would not be co-ordinated. Through the workgroup process, and having regard to these views, Ofgem has developed proposals to address these concerns. These are set out below:

- ◆ **Reasonable endeavours obligation on frequency of changes.** Ofgem intends to propose a licence modification to impose an obligation on NTS and DN GT licensees to use reasonable endeavours not to change their gas transportation charges other than on a specified date each year, for example 1 October. Ofgem invites respondents' views on this proposed modification; and
- ◆ **Co-ordination by the Joint Office (JO).** Ofgem proposes that the JO of the NTS and DN GTs will provide the function of running all consultations on proposed amendments to the charging methodologies. Ofgem considers that this should assist in ensuring that changes to charging methodologies are widely consulted upon to help ensure co-ordination between DNs where appropriate. The arrangements for the JO's involvement in this process will need to be defined in this licence condition.

- 5.27. Transco has outlined to Ofgem that (notwithstanding that there is a very limited relationship between the NTS and DNs in respect of LNG Storage arrangements in relation to “boil off”) given that LNG Storage Facilities are connected to the NTS, the most appropriate location for the licence obligations currently in Transco’s existing GT licence relating to LNG Storage should be Transco’s NTS-GT licence only. Ofgem invites respondents’ views on this issue. Following consideration of respondents’ views, if the Authority considers that Transco’s view should be adopted then it may be possible to remove all references to LNG from conditions in the DN-GT licences. If such an approach is adopted, Special Conditions dealing with LNG Storage would be included in the NTS-GT licence only.
- 5.28. If, following consideration of respondents’ views, the Authority is not persuaded by Transco’s preferred approach then it may be necessary to have a series of Standard Special Conditions relating to LNG storage applying both to NTS and DN-GT licences going forward. In reaching these conclusions the Authority will consider both the current arrangements for LNG Storage and also any future developments. Again, Ofgem would welcome respondents’ views on this issue.
- 5.29. Given the changes from the designated version of standard condition 4 that will be necessary, Ofgem is proposing to introduce a new Standard Special Condition containing the provisions of this condition that would apply to NTS and DN-GT licences. In respect of all NTS and DN-GT licensees, it is proposed that the Secretary of State designated version of this condition would apply, then the new Standard Special Condition would be introduced and then the designated Standard Condition would be switched off. Finally, Amended Standard Condition 4 would then be taken out of the NTS and DN-GT licences and the licensee would comply with the Standard Special Condition.
- 5.30. It is currently Ofgem’s intention to propose the required modifications as part of the section 23 notice to be published in November 2004. However, further amendments may be necessary as part of the Section 8AA transfer process.
- 5.31. Ofgem welcomes respondents’ views on its proposals to modify Amended Standard Condition 4.

Amended Standard Condition 4A – Obligations as Regards Charging Methodology

Description

- 5.32. This Amended Standard Condition describes the objectives of a charging methodology. These include:
- ◆ cost reflectivity;
 - ◆ efficiency;
 - ◆ facilitation of competition; and
 - ◆ reasonable profit for the licensee (provided that this element is not disapplied).
- 5.33. The condition additionally sets out the process to be followed where a licensee wishes to modify its charging methodology subject to the Authority's right of veto. It also requires the publication of an annual report on the application of the charging methodology during the 12 months preceding 1 October of that year, together with a statement by the licensee on the extent to which the relevant methodology objectives have been achieved in that period, whether they could have been more closely achieved through modification of the methodology, and what modifications should be made. Further, the condition also governs the publication of other information to the Authority relating to costs incurred or the charging methodology.

Proposed changes

- 5.34. As set out in relation to Amended Standard Condition 4, modifications will be necessary to this Amended Standard Condition to accommodate the following:
- ◆ the creation of a reasonable endeavours obligation on frequency of changes and that reasonable endeavours should be used to ensure that all changes are effected on a specified date in the year (for instance, 1 October); and

- ◆ the involvement of the JO in the process for amending the methodologies.
- 5.35. Ofgem would welcome respondents' views on these proposed modifications.
- 5.36. In addition, Ofgem considers it appropriate to introduce an obligation on NTS and DN-GT licence holders to keep the charging methodology under review at all times in order to ensure that there is co-ordination, consistency and best practice in the achievement of the relevant objectives. This would also ensure that a degree of consistency is maintained with the electricity industry. Ofgem would welcome respondents' views on this proposed change.
- 5.37. With regard to the references in the discussion of Amended Standard Condition 4A on LNG storage arrangements, Ofgem would refer respondents to its comments relating to the treatment of LNG generally set out in relation to Amended Standard Condition 4 above.
- 5.38. As the condition also contains reference to auction methodologies, it is Ofgem's proposal that these references should be retained in all NTS and DN-GT licences. These conditions will not have any practical effect in relation to those licences which do not currently conduct auctions to allocate capacity, but may have applications in the future if auctions are introduced.
- 5.39. As with Amended Standard Condition 4 above, given the changes to the designated version of Standard Condition 4A that will be necessary, Ofgem is proposing a new Standard Special Condition containing the provisions of this condition which would apply to NTS and DN-GT licences. The Standard Condition 4A designated by the Secretary of State would then be introduced into the licence and switched off once the Standard Special Condition had been introduced, and then the existing Amended Standard Condition would be taken out of the licence.
- 5.40. It is currently Ofgem's intention to propose the required modifications as part of the section 23 notice to be published in November 2004. However, further modifications may be necessary as part of the section 8AA transfer process.
- 5.41. Ofgem welcomes respondents' views on its proposals to modify Amended Standard Condition 4A.

Standard Condition 4B – Connection Charges etc

Description

- 5.42. This condition grants the right to charge the person whose premises are being connected for the costs of supplying and laying pipe. In the case of domestic connections, further provisions are specified.
- 5.43. Standard Condition 4B also sets out the requirements for the provision and publication of information relating to the methods and principles for setting connection charges and any subsequent modifications.
- 5.44. The condition obliges the GT not to show any undue preference towards, or undue discrimination against, any person who operates or proposes to operate a pipeline system in relation to the connection of that pipeline system to the licensee's pipeline system.
- 5.45. Further provisions include the obligation to maintain a register of its pipes which is available for inspection.

Proposed changes

- 5.46. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 4B will apply to all GT licences including NTS and DN-GTs.
- 5.47. Ofgem welcomes respondents' views on its proposals not to amend Standard Condition 4B.

Standard Condition 4C – Charging of Gas Shippers – Supplemental Connection Charges

Description

- 5.48. Standard Condition 4C enables the licensee to include 'supplementary charges' in its charges for the conveyance of gas to premises in areas designated by the Authority which have not previously been supplied by gas (or have not been supplied within the last 3 years at a rate of gas below 2,196,000 kilowatt hours a year) or are not within 23 metres of a relevant main.

- 5.49. This condition is expressly stated to be time limited in application (application for designations had to be received by 31 December 2003).

Proposed changes

- 5.50. Ofgem is currently minded to retain this condition in the NTS and DN GT licences but to switch it off. While this would mean that these licences are different from other GT licences which are subject to the designated condition, Ofgem has considered the issue of ensuring no undue discrimination and is satisfied that its obligations will be met as the obligation has no ongoing practical effect in any GT licence. Ofgem would propose to similarly modify other GT licences in due course³⁸.
- 5.51. It is currently Ofgem's intention to propose these modifications as part of the section 23 Notice to be published in November 2004.
- 5.52. Ofgem welcomes respondents' views on its proposals to switch off Standard Condition 4C.

Amended Standard Condition 4D – Conduct of Transportation Business

Description

- 5.53. This condition obliges the licensee to conduct its transportation business to ensure that neither it, nor any affiliate or related undertaking, or any gas shipper or supplier receives any unfair commercial advantage including any such advantage from a preferential or discriminatory arrangement. The definition of transportation business is amended in this condition in Transco's licence to include LNG Storage. Furthermore, paragraph 4 of this condition means that the definition of the transportation business includes metering services and meter reading services.

Proposed changes

- 5.54. The designated Standard Condition does not contain provisions relating to metering (as defined in Transco's existing GT licence). In addition, while the Standard Condition does have reference to storage, the references do not reflect

the way LNG storage has developed in Transco's business. Ofgem would welcome respondents' views on whether the provisions in this Amended Standard Condition relating to metering and LNG storage arrangements should apply to the NTS and DN-GT licences.

- 5.55. With regard to the references to LNG storage, Ofgem would refer respondents to its comments relating to the treatment of LNG storage as generally set out in relation to Amended Standard Condition 4 above.
- 5.56. Furthermore, Ofgem recognises that the licensing arrangements need to be robust in relation to all parties (including Transco) operating LNG facilities. Ofgem would welcome respondents' views on the most appropriate way of achieving this within the structure of the licence set out in Chapter 3.
- 5.57. With respect to metering arrangements, Transco has suggested that if the metering obligation in paragraph 4 is retained then the condition should become a Standard Special Condition, and therefore be retained in both NTS and DN-GT licences. Again, Ofgem would welcome respondents' views on this issue.
- 5.58. Ofgem therefore proposes a new Standard Special Condition containing the provisions in this condition which would apply to the NTS and DN-GT licences. As before, the Standard Condition would be reintroduced to the licence and then switched off following the introduction of the Standard Special Condition. After this Amended Standard Condition 4D would be taken out of the licences.
- 5.59. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.60. Ofgem further considers that this condition, in conjunction with other conditions in the GT licence, may require further modification to deal with any potential competition issues which may arise once the implications of the potential purchasers' identities have been considered. If such further modifications are required, for the avoidance of doubt, it will be Transco, as the relevant licence holder at the time of modification, who will be asked to consent to the proposed modifications. Notwithstanding this, Ofgem would of course welcome views on competition issues including, without limitation, the views of potential

purchasers. It is likely, due to the timescales of Transco's proposed transaction, that these further modifications would be considered as part of the section 8AA process.

- 5.61. Ofgem welcomes respondents' views on its proposals in relation to Amended Standard Condition 4D.

Amended Standard Condition 4E – Requirement to Enter into Transportation Arrangements in Conformity with the Network Code

Description

- 5.62. This condition requires the licensee to enter into transportation arrangements that conform with the relevant provisions of the Network Code, unless the Authority accepts otherwise. For the purposes of this condition transportation arrangements include LNG Storage arrangements. The condition additionally requires the licensee to comply with any obligation in the Network Code to disclose information relating to the following:
- ◆ the operation of the licensee's pipeline system; or
 - ◆ any market relating to the licensee's pipeline system.
- 5.63. The condition also provides that the Authority may exclude LNG storage from the scope of the condition and that the scope of the condition may be limited to gas consisting wholly or mainly of methane.

Proposed changes

- 5.64. This condition will need to be amended to reflect the new commercial arrangements. The governance of these arrangements is still under consideration within the workgroups. As explained earlier in this document, two alternative approaches are being considered. These can be summarised as:
- ◆ **UNC approach.** Under this approach all of the commercial arrangements would be contained within the UNC, including the arrangements at the NTS offtake points; or

- ◆ **Transco preferred approach of UNC plus offtake code.** Under this approach the commercial arrangements with the exception of NTS offtakes would be contained within the UNC. A separate offtake code would be put in place to deal with the commercial arrangements at all NTS offtakes (i.e. DNs and all NTS direct connect offtakes).

- 5.65. Transco has highlighted that paragraph 5 of the condition relating to the disclosure of information will need to be modified to reflect the new arrangements. Further modifications may also be required.
- 5.66. Transco has proposed a similar approach to LNG as set out in relation to Amended Standard Condition 4 above. Again, the Authority would welcome respondents' views on this issue prior to making its recommendation.
- 5.67. In broad terms, Ofgem can therefore identify at least 3 areas where modifications are likely to be required to Amended Standard Condition 4E. These are set out below:

- ◆ a Standard Special Condition may be required for all NTS and DN-GT licensees to require them to enter into transportation arrangements in accordance with the UNC;
- ◆ a Special Condition may be required in the NTS GT licence depending on the treatment afforded to LNG Storage arrangements³⁹; and
- ◆ a Standard Special Condition may be required for both the NTS and DN-GT licensees containing an obligation to accede to, and comply with any, offtake code arrangements. The exact form of this obligation will be subject to the outcome of workgroup discussions and Ofgem's future decisions in this area. It should be noted that it may be necessary to impose a Special Condition on the NTS-GT licensee to establish an offtake code this is considered further below in Amended Standard Condition 9.

³⁹ If the Authority decides LNG should appear in both the NTS and the DN-GT licences this may require a Standard Special Conditions applicable to both the NTS and the DNs.

- 5.68. As before, Standard Condition 4E would be introduced into the licences and then switched off once the appropriate new conditions have been introduced. Amended Standard Condition 4E would then be modified out of the NTS and DN-GT licences. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004. However, we recognise that further work through the workgroups will be required and that therefore these proposals may have to be considered at the section 8AA stage of the process.
- 5.69. Ofgem welcomes respondents' views on its proposals with respect to Amended Standard Condition 4E.

Standard Condition 5 – System Development Obligations

Description

- 5.70. Standard Condition 5 sets out the requirements on a licensee applying for an extension of its licence under section 7(4) of the Gas Act to give notice to the HSE and (if required) the Designated Registrar of Pipes.
- 5.71. It also governs the procedure that the licensee must adhere to before carrying out any works for the construction of the high pressure pipeline, including requiring it to:
- ◆ give at least one year notice to the HSE; and
 - ◆ inform the relevant planning authorities and keep the relevant shippers / suppliers informed.
- 5.72. The description of the process includes the type of data to be provided to the HSE and planning authorities as well as obligations for consultation and provides for the possibility of the Secretary of State blocking construction in light of, for example, representations from the HSE.
- 5.73. The condition includes an obligation to keep records of, for example, pipelines and premises connected to the system, and shippers and suppliers who have supplied gas to premises connected to the licensee's pipeline system during the last five years.

Proposed changes

- 5.74. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 5 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.75. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 5.

Standard Condition 5A – Information to be Provided to the Designated Registrar of Pipes

Description

- 5.76. Subject to the condition becoming applicable (by the Authority issuing a direction), this condition describes the information that the licensee is obliged to provide to the Designated Registrar of Pipes within 28 days of commissioning a new main or changing existing data. This condition additionally requires the licensee to give 7 days notice to the registrar of the likely location of a pipe before it is commissioned.
- 5.77. There is currently no Designated Registrar of Pipes. The condition is included in Transco's existing GT licence, but requires a direction from the Authority, following consultation, in order for Transco to be obliged to comply with it. To date, no such direction has been made by the Authority.

Proposed changes

- 5.78. Ofgem has received representations during the course of the consultation process on DN Sales that have recommended that the Authority should direct for this licence condition to become operative. We address issues arising on this point in the discussion on Standard Condition 33.
- 5.79. Subject to consideration of respondents' views, Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 5A will continue to apply to all GT licences including NTS and DN-GTs.
- 5.80. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 5A.

Amended Standard Condition 6 – Emergency Services and Enquiry Service Obligations

Description

- 5.81. Amended Standard Condition 6 sets out a number of obligations on the licensee with respect to emergency services. These include:
- ◆ **telephone service.** A requirement that the licensee must establish or procure the establishment of and operate and maintain a single free of charge, efficiently run, well publicised, continuously manned emergency telephone number, including special arrangements for the deaf and blind. The operation of this service should not discriminate between persons or classes of persons and should not restrict, distort or prevent competition in the supply of gas;
 - ◆ **domestic supplies and minor repairs.** A requirement to prevent gas escapes in such a way as to maintain as far as reasonably practicable the supply to domestic premises for heating and cooking. The condition also requires the licensee to carry out minor repairs in the context of the prevention of gas escapes (subject to specified time/cost limits); and
 - ◆ **requirements on personnel.** A requirement for work to be executed by adequately trained persons able to recognise leakage of carbon monoxide who will inform the owner or the occupier about the carbon monoxide risks.
- 5.82. This condition also prohibits material changes to the above arrangements without the consent of the Authority and obliges the licensee to be in conformity with these arrangements, particularly in the case of domestic customers.
- 5.83. The condition obliges the licensee to maintain the supply of gas where possible, having due regard to the over-riding importance of safety. The licensee is also obliged to have a list of priority customers with respect to the maintenance of supply, and consult on this list ensuring consistency with the Secretary of State's directions. In the event of a significant shortage of gas, or a substantial part of Great Britain being affected, the licensee is obliged to consult with the network emergency co-ordinator or the Secretary of State. The condition also ensures

adequate remuneration of emergency services through a link of charges with reasonable costs and reasonable profit allowances.

- 5.84. As explained before, there is a statutory obligation on British Gas plc (whose statutory successor is Transco) to provide the telephone service. Ofgem considers that, consistent with the current arrangements regarding IGTs, the provisions of this condition allow GTs, other than Transco, to discharge their obligations to provide a telephone service contractually via Transco.

Proposed changes

- 5.85. Ofgem is therefore proposing that this Amended Standard Condition becomes a Standard Special Condition applicable to NTS and DN GT licences⁴⁰. Standard Condition 6 would be introduced and then switched off once the Standard Special Condition has been introduced. Finally, Amended Standard Condition 6 would be modified out of the NTS and DN GT licences.
- 5.86. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.87. Ofgem welcomes respondents' views on its proposals with respect to Amended Standard Condition 6.
- 5.88. Through the workgroup process Ofgem has received representations from a number of parties concerning emergency service provisions. In particular, it has been suggested that the terms of this condition could be broadened or a new condition introduced to cover emergency services provided by another gas transporter in circumstances other than when a major loss of supply has occurred. These issues are considered in Chapter 4 and Ofgem would welcome respondents' views on these matters.

⁴⁰ Other GTs (i.e. IGTs) will continue to have the same provisions operative through their Amended Standard Condition 6.

Standard Condition 7 – Provision of Information Relating to Gas Illegally Taken

Description

- 5.89. This condition allows for the investigation and recovery of the value of gas illegally taken (as stipulated under Schedule 2B of the Gas Act), as well as the amendment of shipper charges and payment of allowances to suppliers to account for the costs incurred during this process subject to the provisions of Schedule 2B of the Gas Act.
- 5.90. The licensee is also required to restore the safety of meters or installations at the request of the relevant shipper, where the meter or installation is unsafe as the result of the commission of an offence or an attempted offence.

Proposed changes

- 5.91. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 7 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.92. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 7.

Amended Standard Condition 8 – Provision and Return of meters

- 5.93. Amended Standard Condition 8 places a requirement on Transco to comply with any reasonable request received from a relevant supplier to provide, through a Meter Asset Manager, and install at the premises of a domestic customer a gas meter owned by Transco which is of a type specified by the supplier. Prior to the implementation of the Review of Gas Metering Arrangements (RGMA) on 12 July 2004, Transco was obliged to comply with any request received from a relevant shipper. However, in compliance with the provisions of the supplier 'hub', the licence was amended to reflect that Transco is required to comply with any request received from a supplier.
- 5.94. The term Meter Asset Manager is used within this condition to refer to a person or undertaking approved by the Authority as possessing satisfactory expertise to provide Metering Services. Approval by the Authority in this respect refers to

approval in relation to the Meter Asset Managers Code of Practice which seeks to bring together all relevant technical documentation and legal requirements covering the life cycle of a gas meter installation.

Proposed changes

- 5.95. Ofgem considers that Amended Standard Condition 8 should reside within both the NTS and DN GT-licences, as a Standard Special Condition, ensuring that the relevant GT is required to comply with any request received from a supplier in relation to the provision of a meter. In meeting this obligation, the GT will be required to contract with Transco metering services, or an alternative metering services provider, for the provision of these services to customers on its network. While it is Ofgem's policy position to reintroduce Standard Conditions, in this instance, we consider that it would not be appropriate. Therefore Ofgem proposes that a new Special Standard Condition will be introduced.
- 5.96. Ofgem welcomes respondents' views on its proposals to modify Amended Standard Condition 8. It is currently Ofgem's intention to propose these modifications as part of section 23 notice to be published in November 2004.

Amended Standard Condition 9 – Network Code

Description

- 5.97. This condition obliges the licensee to establish a Network Code calculated to facilitate the achievement of one of a number of specified code objectives. The code objectives are:
- ◆ the efficient and economic operation by the licensee of its pipeline system;
 - ◆ so far as is consistent with the above, the efficient discharge of its obligations under its GT licence;
 - ◆ so far as is consistent with the above, the securing of effective competition between relevant shippers and relevant suppliers; and
 - ◆ so far as is consistent with the above, 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.

- 5.98. The condition provides that where the Network Code makes provision for system balancing by an independent party, the licensee is required to endeavour to appoint a person with appropriate finances, skills and systems recognised by the Financial Services Authority (FSA) as an investment exchange, or whose authority to act in such a capacity has not been revoked or expired.
- 5.99. The licensee is required to establish Code modification rules which set out the Network Code modification procedures for reviewing the Network Code and the conduct of proposals. The Authority's approval is required to modify the Network Code. The Authority also has the power to direct that modification can be made to the Network Code without consultation.
- 5.100. Changes to Code modification rules may only take place with the consent of the Authority following consultation with all relevant shippers.
- 5.101. Paragraph 7(b) of this condition also provides the option of a modification being made outside of the usual modification rules but with the consent of the Authority. This is typically used for the correction of typographical errors, maintaining up to date references to non-Network Code documents, other general house-keeping changes that are considered to be immaterial to the contract, and for which the application of the full modification process may be disproportionate, unnecessarily lengthy and expensive. However, the Authority has also used this condition (infrequently) when rapid market action is required (for example in the case of insolvencies of major shippers and/or suppliers).
- 5.102. The condition requires the licensee to prepare and publish a summary of the Network Code and Code modification rules and to send a copy of these documents to anyone requesting them.

Proposed changes

- 5.103. The governance arrangements that will be necessary to support a potential DN Sale have been the subject of extensive discussions within the workgroups. These discussions have reached conclusions on a number of key issues but as discussed in relation to Amended Standard Condition 4E there are a number of

issues, particularly surrounding the governance of the NTS offtake arrangements which have yet to be finalised.

- 5.104. However, it is clear to Ofgem that Amended Standard Condition 9 will need to be substantially revised to support the final form of the proposed commercial arrangements.
- 5.105. Under Transco's proposals, the Network Code will be modified to create a UNC with short form codes (SFCs) for each gas transporter that is a signatory to the UNC. The SFCs would be subject to the same modification rules and procedures as the UNC. It is envisaged that the UNC will initially contain all of the rules associated with the commercial arrangements, with the SFCs forming effectively framework arrangements which bind parties to the UNC. Ofgem would welcome respondents' views on Transco's proposals.
- 5.106. The Authority and the workgroups reached the conclusion that agency arrangements and the JO are necessary in a divested industry structure to prevent any undue discrimination on the behalf of Transco in the running of the modification process. Ofgem considers that Amended Standard Condition 9 will need to be modified to provide for the obligation on the licensee to establish both of these functions.
- 5.107. The workgroups additionally considered that to coincide with the introduction of the agency and the JO it will be necessary to introduce a new relevant objective for the UNC. In particular, it was considered that a relevant objective should be introduced similar to the relevant obligation under the Balancing and Settlement Code ("BSC") to ensure the co-ordinated and efficient operation of the NTS and the former Transco distribution networks which would include efficiency in the administration of the arrangements⁴¹. Ofgem welcomes respondents' views on whether this new relevant objective should be introduced.
- 5.108. With regard to the code modification rules, the Authority has recently⁴² approved a modification proposal to the Network Code which inserts the

⁴¹ This BSC objective detailed in standard licence condition C3 (3) (d) of the electricity transmission licence states that 'The objectives are...promoting efficiency in the implementation and administration of the balancing and settlement arrangements

⁴² *Ofgem decision letter 0679 'Formally include the Network Code modification rules within the Network Code'*, Ofgem, June 2004.

modification rules into the Network Code itself. Ofgem considers that it is important that the code modification rules continue to be set out in the Network Code going forward, particularly as the arrangements may need to change as the proposed divested structure develops. Amended Standard Condition 9 will therefore be modified to take into account these conclusions. Ofgem additionally considers that it is important that the scope of the functions of the Agency are also contained within the Network Code, again to ensure that all participants can raise modifications against the relevant objective of the Code.

5.109. As part of the review that Ofgem, in conjunction with the workgroups, has carried out, consideration has been given to whether it would continue to be appropriate for a UNC to be modified only on the basis of the consent of the Authority. The view amongst the workgroup was that it would not. Ofgem would therefore welcome respondents' views on whether:

- ◆ the consent to modify should be removed entirely;
- ◆ the purpose of the comment to modify should be clarified within the licence and/or modification rules; or
- ◆ it should be retained as it is.

5.110. As set out with respect to Amended Standard Condition 4E, the workgroups and Ofgem are still considering the appropriate governance arrangements for offtakes from the NTS. If the new commercial offtake arrangements from the NTS are contained within the UNC then it is likely that no further modifications will be necessary. If, however, an offtake code is required then detailed consideration will need to be given to the appropriate obligations on the NTS and other licensees as well as the inter-relationship between these obligations and the obligations that licensees will be under with respect to the UNC. We would welcome respondents' views on this point.

5.111. As outlined above, it is likely that substantial modifications will be required to Amended Standard Condition 9. It is also possible that a new licence provision concerning the offtake arrangements will be required. Ofgem is intending to introduce these new provisions as Standard Special Conditions in the NTS and DN-GT licences. As before, the designated Standard Condition will be introduced and will be switched off following the introduction of the Standard

Special Conditions. The Amended Standard Condition will then be taken out of the NTS and DN-GT licences.

- 5.112. The condition also has references to LNG. Ofgem refers respondents to its comments relating to the treatment of LNG generally, set out in relation to Amended Standard Condition 4 above.
- 5.113. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004. However, we recognise that further work through the workgroups will be required and therefore that these proposals may have to be considered at the section 8AA stage of the process.
- 5.114. Ofgem welcomes respondents' views on its proposals to modify Amended Standard Condition 9.

Standard Condition 13 – Change co-ordination for the Utilities Act 2000

Description

- 5.115. This condition requires the licensee to take all reasonable measures to secure and implement, and not to delay or prevent changes to specified industry framework documents which were necessary or expedient to give full effect to the Utilities Act 2000. This condition is now time expired.

Proposed changes

- 5.116. Ofgem proposes to retain this condition within the licences of the NTS and DN GT licensees but proposes to switch the condition off. While this condition remains technically operative in the licences of other GTs, it has practically no effect as it is time expired, and therefore raises no issues of discrimination. At some point in the future (outside of the DN sales process) Ofgem would propose to remove this condition from all GT licences.
- 5.117. Ofgem welcomes respondents' views on its proposal not to modify Standard Condition 13.

Standard Condition 14 – The Supply Point Administration Agreement

Description

- 5.118. Standard Condition 14 was recently introduced by the Authority and requires the licensee to be a party to and comply with the relevant provisions of the Supply Point Administration Agreement (SPAA).

Proposed changes

- 5.119. Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 14 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.120. Ofgem welcomes respondents' views on its proposal regarding Standard Condition 14.

Standard Condition 16 – Pipeline System Security Standards

Description

- 5.121. This condition is one of a number of conditions which regulates security of supply. The licensee is required to plan and develop its pipeline system so as to enable it to meet the peak daily demand for gas such that the ability of the pipeline system to meet that demand is only expected to be exceeded in 1 year out of 20 based on the previous 50 years of data (the 1 in 20 obligation).
- 5.122. Standard Condition 16 sets out the rules for the modification of the 1 in 20 obligation and includes consultation with relevant parties including the HSE amongst others.

Proposed changes

- 5.123. Ofgem has considered in the context of the offtake arrangements RIA⁴³ whether, in the event of DN Sales proceeding, the 1 in 20 obligation should be removed. The Authority reached the decision that this was not appropriate at this time and that further consideration of the implications of the removal of the 1 in 20 obligation would be necessary outside of DN Sales' timescales.

⁴³ *National Grid Transco – Potential sale of gas distribution network businesses, Offtake Arrangements Regulatory Impact Assessment*, Ofgem, June 2004.

- 5.124. In its decision on the offtake arrangements, the Authority concluded that the 1 in 20 obligation should remain in place on both the NTS and DN-GTs with respect to premises that are connected to these networks. The model which the Authority has indicated that it considers should be adopted for the offtake arrangements will require DN-GTs to book NTS exit capacity consistent with its 1 in 20 obligations. Ofgem therefore considers that the current definition of the 1 in 20 obligation applying to premises does not need to be modified. Ofgem would welcome respondents' views on this issue.
- 5.125. Ofgem is, therefore, currently minded not to propose any modifications to this condition, i.e. Standard Condition 16 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.126. Ofgem welcomes respondents' views on its proposals regarding Standard Condition 16.

Amended Standard Condition 17 – Provision of Services for Persons who are of Pensionable Age or Disabled or Chronically Sick: Arrangements with respect to Meters

Description

- 5.127. Amended Standard Condition 17 requires that Transco must comply with any request received from a supplier in relation to the repositioning of meters that it owns for customers who are of pensionable age, disabled or chronically sick. This is provided that the relevant supplier pays Transco's reasonable expenses in doing so. This condition is amended in Transco's existing GT licence only.

Proposed changes

- 5.128. Ofgem considers that the DN-GTs should have an obligation of this nature within their licences as DN-GTs and will be required to provide metering services of last resort through the obligations currently contained in Standard Condition 8. Although the licence condition would not appear to be required for the NTS given that it does not have any domestic premises currently connected to it, Ofgem is mindful that the NTS-GT licence holder will continue to have permission under the Gas Act to convey gas to all premises including

domestic premises. Ofgem therefore considers that it should apply both to the NTS and DN-GT licences.

5.129. Ofgem proposes to include this as a Standard Special Condition applicable to both the NTS and DN-GT licences. As before, once the Standard Condition has been reintroduced and the Standard Special Condition has been introduced, the Standard Condition would be switched off and the Amended Standard Condition 17 would then be modified out of NTS and DN-GT licences.

5.130. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.

5.131. Ofgem welcomes respondents' views on its proposals regarding Amended Standard Condition 17.

Standard Condition 18 – Provision of Services for Persons who are Blind or Deaf

Description

5.132. This condition governs the code of practice of special services in respect of domestic customers who have hearing or sight problems including arrangements for enquiry and complaints.

5.133. The condition requires the licensee to put in place a code of practice by 1 November 2001.

Proposed changes

5.134. As with Standard Condition 17, although the licence condition would not appear to be required for the NTS given it does not have any domestic premises currently connected to it, Ofgem is mindful that the NTS-GT licence holder will continue to have permission under the Gas Act to supply gas to all premises. Ofgem therefore considers that it should apply both to the NTS and DN-GT licences.

5.135. As set out above there is an obligation to have a code in place by 1 November 2001. This obligation appears in all GT licences and has been inserted in two GT licences granted since 1 November 2001. Clearly, this raises the possibility

that the new GT licensees would automatically be in breach of this provision. Ofgem would propose to modify this condition by removing the time redundant wording in the condition and replacing it with a new date, together with wording providing for the date to be varied (i.e. a specific date or the date on which the licence is granted, whichever is the later).

5.136. Ofgem proposes to include the condition as a Standard Special Condition in the NTS and DN-GT licences. The Standard Special Condition would be introduced and then Standard Condition 18 would therefore be switched off in the NTS and DN-GT licences.

5.137. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.

5.138. Ofgem welcomes respondents' views on its proposals to amend Standard Condition 18 in the context of DN Sales.

Standard Condition 19 – Arrangements in Respect of Powers of Entry

Description

5.139. Standard Condition 19 requires the licence holder to prepare and submit a statement to the Authority regarding its proposed arrangements in respect of the steps to be taken under Standard Condition 19A (Authorisation of Officers). The condition also includes arrangements regarding the extension of the licence together with a best endeavours obligation to conduct itself in conformity with the arrangements.

Proposed changes

5.140. This licence condition relates to both domestic and non-domestic premises. Ofgem considers that it is appropriate that it should apply to both the NTS and DN-GT licences.

5.141. Ofgem is, therefore, currently minded not to propose any modifications to this condition other than to amend the cross reference to Standard Condition 22 as this will become a Standard Special Condition under the proposals for that condition.

- 5.142. Ofgem welcomes respondents' views on its proposal to amend Standard Condition 19 in the context of DN Sales.

Standard Condition 19A – Authorisation of Officers

Description

- 5.143. This condition describes the requirements for officers to be appropriately qualified, identifiable by the public and to ensure that their equipment/identification is not misused. It also obliges licensees to inform relevant shippers, naming the agent in question.

Proposed changes

- 5.144. As with Standard Condition 19, this licence condition relates to both domestic and non-domestic premises. As such, Ofgem considers that it is appropriate that it should apply to both the NTS and DN-GT licences.
- 5.145. Ofgem is, therefore, currently minded not to propose any modifications to this condition, i.e. Standard Condition 19A will continue to apply to all GT licences including NTS and DN-GTs.
- 5.146. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 19A in the context of DN Sales.

Standard Condition 19B – Exercise of Powers of Entry

Description

- 5.147. Standard Condition 19B requires the licensee to use reasonable endeavours to avoid undue disturbance to owners or occupiers of premises as a result of the exercise of the powers of entry conferred by Schedule 2B of the Gas Act.

Proposed changes

- 5.148. As with Standard Conditions 19 and 19A, this licence condition relates to both domestic and non-domestic premises. Ofgem considers that it is appropriate that it should apply to both the NTS and DN-GT licences.

- 5.149. Ofgem is, therefore, currently minded not to propose any modifications to this condition, i.e. Standard Condition 19B will continue to apply to all GT licences including NTS and DN-GTs.
- 5.150. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 19B.

Amended Standard Condition 20 – Standards of Performance

Description

- 5.151. This condition describes the conditions of payment of compensation to consumers under s33AA of the Gas Act. It enables the licensee to make payments direct to consumers or via shippers, as long as the shipper is aware that the payment is for onward transmission to the consumer affected.
- 5.152. This condition was originally an Amended Standard Condition in Transco's existing GT licence. However, this condition has been modified such that only paragraph 8 of the condition now exists in all GT licences including Transco's. As such, while in the version of Transco's licence attached this is described as an Amended Standard Condition it is in fact currently a Standard Condition common to all GTs.

Proposed Changes

- 5.153. Ofgem considers that it is appropriate that it should continue to apply to both the NTS and DN-GT licences.
- 5.154. Therefore, Ofgem is currently minded not to propose any modifications to this condition i.e. Standard Condition 20 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.155. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 20.

Standard Condition 21– Complaint Handling Procedure

Description

- 5.156. The condition requires the licensee to put in place a code of practice by 1 November 2001 detailing the procedure for handling complaints from domestic customers about the manner in which the licensee conducts its transportation business. It is a requirement that this code is submitted to the Authority and that such code specifies the time periods within which categories of complaints will be resolved.

Proposed changes

- 5.157. As with Standard Condition 18, although the licence condition would not appear to be required for the NTS given it does not have any domestic premises currently connected to it, Ofgem is mindful that the NTS-GT licence holder will continue to have permission under the Gas Act to provide gas to all premises. Ofgem therefore considers that it should apply both to the NTS and DN-GT licences.
- 5.158. As set out above, there is an obligation to have a code in place by 1 November 2001. This obligation appears in all GT licences and has been inserted in two GT licences granted since 1 November 2001. Clearly, this raises the possibility that the new GT licensees would automatically be in breach of this provision. Ofgem would propose to modify this condition by removing the time redundant wording in the condition and replacing it with a new date, together with wording providing for the date to be varied (i.e. a specific date or the date on which the licence is granted, whichever is the later).
- 5.159. Ofgem proposes to include the condition as a Standard Special Condition in the NTS and DN GT licences. Once the Standard Special Condition has been introduced, Standard Condition 21 would then be switched off in the NTS and DN-GT licences.
- 5.160. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004. However, we recognise that further work is needed through the workgroups and therefore that these proposals may have to be considered at the section 8AA stage of the process.

- 5.161. Ofgem welcomes respondents' views on its proposals to amend Standard Condition 21 in the context of DN Sales.

Standard Condition 22 – Preparation, Review of and Compliance with Statements and Codes

Description

- 5.162. Standard Condition 22 applies to any codes that are required to be prepared under Standard Conditions 18, 19 and 21. The licensee is required, prior to submitting these codes to the Authority, to consult with the Consumer Council. Within 30 days of submission of a code, where the Authority considers it is insufficient to meet the requirements of this condition the licensee is required to make any changes that the Authority requires.
- 5.163. On the request of the Authority, the licensee is required to review the code and its manner of operation to determine whether any modification should be made to it or the manner of operation. In conducting any such review, the licensee is required to consult with and have regard to any representations made by the Consumer Council. As before, the revisions are subject to the consent of the Authority.
- 5.164. The condition also requires the licensee to submit a statement of changes to the Authority and the Consumer Council and to draw the code to the attention of customers and provide a free copy on request.

Proposed changes

- 5.165. Ofgem is, currently, minded not to propose any modifications to this condition other than to make cross reference changes to reflect the changes envisaged to Standard Condition 18 and 21.
- 5.166. Ofgem welcomes respondents' views on its proposal to amend Standard Condition 22 in the context of DN Sales.

Standard Condition 23 – Record of and Report on Performance

Description

- 5.167. This condition requires a record of performance in relation to the general operation of the arrangements referred to in Standard Conditions 18 to 22, (and others if requested by the Authority) and the provision of services to domestic customers.
- 5.168. The licensee must publish and provide an annual report on this to the Authority and the Consumer Council and send free copies on request.

Proposed changes

- 5.169. Ofgem is currently minded not to propose any modifications to this condition other than to change references to other conditions as with Standard Condition 22.
- 5.170. Ofgem welcomes respondents' views on its proposal to amend Standard Condition 23.

Amended Standard Condition 24 – The Provision of Information to the Authority

Description

- 5.171. This condition requires that such information and reports as the Authority may reasonably require or which may be necessary for it to perform its functions, are provided to the Authority on request (consistent with information that may be compelled to be provided in civil proceedings). The licensee cannot be required to produce any documents or give any information which it could not be compelled to produce or give in evidence in civil proceedings before a court.
- 5.172. In order to ensure the provision of complete information, the licensee is required to obtain legally enforceable undertakings from its ultimate controllers ensure the provision of information. Furthermore, the Authority requires evidence that such undertakings have been obtained.
- 5.173. Save with the written consent of the Authority, the condition prohibits agreements or arrangements with an ultimate controller where there is no such undertaking or there is a breach of such undertaking or the licensee is in breach of any direction under paragraph 3 issued by the Authority.

Proposed changes

- 5.174. The condition will need to be amended to reflect the businesses which each of the NTS-GT and DN-GT licensees will conduct.
- 5.175. In respect of LNG and metering services Ofgem has set out two alternatives in relation to Amended Standard Condition 4 above. Ofgem would welcome respondents' views on the treatment of LNG storage and metering services in the context of this licence condition.
- 5.176. Following consideration of respondents' views, Ofgem would propose to make any necessary modifications to Amended Standard Condition 24 in the section 23 notice due to be issued in November 2004.

Amended Standard Condition 25 – Long Term Development Statement

Description

- 5.177. Amended Standard Condition 25 is a system planning condition obliging the licensee to produce, and update annually, a statement of the forecast use and development of the high pressure system for the next 10 years. The licence holder is obliged to submit a copy of the statement and any revisions to the Authority. The condition contains an obligation requiring publication of the statement and the provision of copies on request. There is a provision to exclude confidential information where the Authority determines that such information is confidential.

Proposed changes

- 5.178. Amended Standard Condition 25 relates to pipe-line systems which include high pressure pipes.
- 5.179. As drafted, Amended Standard Condition 25 relates to pipeline systems which include high pressure pipeline systems. Ofgem considers that, in the context of DN Sales, consideration should be given as to whether the obligation should be placed upon NTS and DN-GT licensees in respect of their networks. This would imply that the NTS and DN-GTs would produce statements for their respective networks.

- 5.180. Alternatively, Transco has suggested that consideration needs to be given to the question of whether a single co-ordinated 10-year statement should be prepared covering the whole of Great Britain and, if so, how such a statement should be prepared. However, Ofgem currently considers this to be inappropriate given its views on the necessary separation requirements that are likely to be required between the NTS and Transco's RDNs.
- 5.181. Ofgem is proposing a new Standard Special Condition dealing with the matters in this condition. Once this is introduced, Standard Condition 25 would be switched off in NTS and DN-GT licences.
- 5.182. Following consideration of respondents' views, Ofgem would propose to make any necessary modifications to Amended Standard Condition 25 in the section 23 notice due to be issued in November 2004. However, we recognise that further work is needed to consider more fully the issues raised above and therefore that these proposals may have to be considered at the section 8AA stage of the process.

Standard Condition 27 – Adjustments of Amounts by Reference to the Retail Price Index

Description

- 5.183. Where a Standard Condition provides for an amount to be adjusted, this condition defines the appropriate adjustment mechanism using the retail price index (RPI).

Proposed changes

- 5.184. Ofgem is currently minded not to propose any modifications to this condition so that the Standard Condition 27 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.185. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 27.

Standard Condition 28 – Termination of Shipping Arrangements

Description

- 5.186. Standard Condition 28 requires the licence holder to keep relevant suppliers informed about terms for the purposes of Standard Condition 22B (Undertakings to be Given by Licensee to Relevant Transporters in Respect of Shipping Charges etc) of their gas suppliers' licences. The condition prohibits the disconnection of customers following termination or expiry of arrangements for the conveyance of gas as long as payments for gas can be expected in line with the terminated or expired arrangements and 48 hours notice has been given to the owner or occupier of the premises and any person who has contracted to buy gas at those premises.

Proposed changes

- 5.187. Ofgem is currently minded not to propose any modifications to this condition so that the Standard Condition 28 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.188. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 28.

Amended Standard Condition 29 – Disposal of Assets

Description

- 5.189. Under the terms of this condition, the licensee must not dispose of, or relinquish operational control over, any transportation asset (as defined) or storage asset (or, in the case of Transco, any LNG storage asset) otherwise than in accordance with this condition. A licence holder is required to give the Authority not less than 2 months' prior written notice of its intention to dispose of, or relinquish operational control over, any transportation asset or storage asset (or, in the case of Transco, any LNG storage asset).
- 5.190. Where a transportation asset comprises a significant part of an independent system operated by the licensee, the licensee must, under paragraph 2A of this condition, save where the Secretary of State consents otherwise, not dispose of the asset or its right to operate the asset until it has put in place or secured suitable alternative arrangements (i.e. arrangements for the conveyance of gas which have a like effect for the purpose of protecting the interests of consumers as per the current provisions of Special Condition 18 – Conveyance to

Independent Systems). The licensee is required to provide the Secretary of State with not less than 60 days advance notice of the proposed disposal and, if the Secretary of State directs the licensee within 30 days of such notification on the grounds that suitable alternative arrangements have not or will not be in place or procured, the licensee is required to comply with the direction.

- 5.191. The licensee may dispose of or relinquish operational control over a transportation or LNG storage asset where the Authority has issued a direction containing a general consent to the transaction of a specified description or the disposal or relinquishment relates to an asset of a specified description and the disposal or relinquishment is in accordance with any conditions to which the consent is subject or where the disposal is required by primary or secondary legislation.
- 5.192. The licensee may dispose of or relinquish operational control where the Authority confirms in writing its consent (which consent may be subject to conditions) or where the Authority fails to notify the licensee of an objection within the notice period specified. Where the transportation asset comprises a significant part of the GB gas conveyance system, the licensee shall notify the Secretary of State at least 60 days in advance and, if the Secretary of State directs the licensee not to proceed within 30 days, the licensee shall comply.
- 5.193. Paragraph 7 of the condition allows the Authority to modify the definition of "disposal" in this condition by omitting "LNG storage asset" from such definition.

Proposed changes

- 5.194. Ofgem considers that it is important that the same degree of regulatory control is maintained after any DN Sales over network owners and their disposal of their assets or relinquishing control over them.
- 5.195. Ofgem considers that in respect of the NTS and DNs, a new Standard Special Condition equivalent to the obligation on electricity distribution and transmission companies would be appropriate. This is in line with the decision following consultation in 2001 on the use of group service companies to provide asset management and potentially network control services in cases where more than one licensed network is owned by the same group of companies.

5.196. In respect of LNG storage assets Ofgem has set out two alternatives earlier in this Chapter. Ofgem would welcome respondents' views on the treatment of LNG storage in the context of this licence condition.

5.197. Following consideration of respondents' views, Ofgem would propose to make any necessary modifications to Amended Standard Condition 29 in the section 23 notice due to be issued in November.

5.198. Ofgem welcomes respondents' views on the issues that arise associated with Amended Standard Condition 29.

Amended Standard Condition 30 – Regulatory Accounts

Description

5.199. Amended Standard Condition 30 sets out the obligations on the licence holder with regards to regulatory accounts including the duties to produce separate annual regulated accounts in the same form as statutory accounts and to provide copies of these to the Authority in respect of the following businesses (the scope of which are currently defined in Amended Standard Condition 1 of the licence):

- ◆ the Transco Business;
- ◆ the Transportation and LNG Storage Business (in so far as it differs from the Transco Business);
- ◆ the Transportation Business;
- ◆ the LNG Storage Business;
- ◆ the Metering Business; and /or
- ◆ the Meter Reading Business

5.200. The condition sets out the nature and period in respect of which the accounts are to be prepared and that such accounts should be accompanied by an auditors' report stating that the accounting statements have been properly prepared and give a true and fair view of the businesses listed above.

- 5.201. Accounting standards may be either current cost accounting or historical cost accounting, but the latter creates the obligation to show separately restated amounts in current costs for profit and loss and cash flow statement, balance sheet, and statement of recognised gains and losses and to provide a related auditors report.
- 5.202. The Authority may take the view that LNG Storage, Metering and Meter Reading should be excluded from the obligation to publish accounting statements if this could prejudice the licensee or the controllers' interests.

Proposed changes

- 5.203. Ofgem considers that that the transparency associated with the regulatory account provisions will be critical in its analysis of the comparative performance of the DN businesses in the restructured industry post DN sales.
- 5.204. When Ofgem published its position paper on DN/DN separation, it was made clear that a condition of its decision not to require DN/DN legal separation would be that the licence conditions in the DN licences facilitated the Authority's access to this information. Ofgem currently considers that when a licensee conducts more than one DN business this condition should ensure that information is provided separately in relation to each individual DN. Ofgem invites respondents' views on this issue and on any additional measures that respondents consider necessary with respect to enhancing transparency for comparative regulatory purposes.
- 5.205. As the Authority is minded to require the legal separation of the NTS and Transco's RDNs, consideration will need to be given as to which businesses are relevant for each licensee. In particular, in respect of LNG storage assets, Ofgem has set out two alternatives earlier in this Chapter. Ofgem would welcome respondents' views on the treatment of LNG storage in the context of this licence condition.
- 5.206. Ofgem's current position is that it is likely that the regulatory accounts provisions will be Standard Special Conditions which would apply to the NTS and DN-GT licences augmented where appropriate by Special Conditions relevant to the circumstances of a particular licensee. Amended Standard Condition 30 would

then be switched off in the NTS and DN-GT licences. Ofgem invites respondents' views on this approach.

5.207. Following consideration of respondents' views, Ofgem would propose to make any necessary modifications to Amended Standard Condition 29 in the section 23 notice due to be issued in November 2004.

5.208. Ofgem welcomes respondents' views on the issues that arise associated with Amended Standard Condition 30.

Standard Condition 30A – Change of Financial Year

Description

5.209. Where the licensee changes its financial year with respect to its statutory accounts, the licensee must provide notice to the Authority specifying the new dates for the current and subsequent financial years which will continue in force unless revoked by the licensee by further notice. The condition further obliges the licensee to furnish and provide to the Authority audited group accounts in the same form as statutory accounts, highlighting any differences in the accounting practices adopted accompanied by an auditors accounts.

Proposed changes

5.210. Ofgem is currently minded not to propose any modifications to this condition so that Standard Condition 30A will continue to apply to all GT licences including NTS and DN-GTs.

5.211. Ofgem welcomes respondents' views on its proposal not to amend Standard Condition 30A.

Amended Standard Condition 31 – Supply Point Administration Services

Description

5.212. Amended Standard Condition 31 obliges the licensee to establish, operate and maintain an information service incorporating a data register comprising information regarding the identity of the relevant gas shipper, the type of equipment installed and an accurate address of each domestic premises.

Transco is required, under this condition, to ensure data amendments that reflect changes in supplier are performed on a timely basis, that data requested is provided in a timely manner and that a suitably published enquiry service is provided free of charge at the point of use to domestic customers. The condition defines what constitutes data and also provides for an obligation to provide information on gas pressure for parties who may require connecting pipelines and other information as needed to verify system reinforcement needs where the requesting party is required to contribute to the costs of reinforcement. The licensee can refuse to provide information if its disclosure would seriously and prejudicially affect its commercial interest.

Proposed changes

- 5.213. Ofgem considers that the amended form of Standard Condition 31 should apply to the NTS and DN-GT licensees. Ofgem is, therefore, currently minded to introduce a Standard Special Condition in NTS and DN-GT licences dealing with the matters in this condition. Standard Condition 31 would then be switched off in the NTS and DN-GT licences.
- 5.214. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.215. Ofgem welcomes respondents' views on these proposals.

Part C

Amended Standard Condition 32 – Interpretation of Section C

Description

- 5.216. This condition sets out the definition of 'permitted purpose' activities which, by the operation of other conditions, the licensee is authorised to pursue in the conduct of its business.
- 5.217. This permitted purpose is used to define the scope of the obligations set out in Section C of the licence (Transportation Services Obligations) and certain Special Conditions. The Amended Standard Condition in Transco's licence defines "permitted purpose" as including Transportation and LNG Storage Business, Meter Business and Meter Reading Business. Accordingly, the definition of

permitted purpose is not the same as that contained in the Standard Condition, as Transco conducts a number of other businesses other than solely a transportation business. The definition also cross-refers to a number of Special Conditions (such as Special Condition 2 – Restriction on Activity and Financial Ring-fencing).

Proposed changes

- 5.218. Ofgem considers that in order to reflect the nature of the business, the amended form of Standard Condition 32 should be retained in respect of Transco's NTS and RDNs as Standard Special Conditions but not for the other DNs. In the case of the other DNs, we consider that amendments should be made separately from the DN Sales process and to revert to the provisions of the designated standard form of this licence condition as far as is possible. Again, as regards process, the Standard Condition would initially be introduced and once the Standard Special Condition has been inserted the Standard Condition would be switched off and ultimately the Amended Standard Condition taken out of the licences.
- 5.219. Consideration will need to be given to the treatment of LNG Storage and metering which may require separate Standard Special Conditions or Special Conditions as explained earlier in this Chapter. Ofgem would welcome respondents' views on this issue.
- 5.220. Ofgem will therefore be proposing modifications to Amended Standard Condition 32.
- 5.221. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.222. Ofgem welcomes respondents' views on its proposals in relation to Amended Standard Condition 32.

Standard Condition 33 – Designated Registrar of Pipes

Description

- 5.223. The Authority may by notice designate the licensee as the "Designated Registrar of Pipes", obliging it to establish, maintain and operate or procure the establishment, operation and maintenance of a service to be known as the Main

Administration Service within the area described in the designation notice from the Authority.

5.224. The Main Administration Service within the area specified is required to fulfil the following functions:

- ◆ receipt and processes of data in a form reasonably specified by the licensee and approved by the Authority;
- ◆ recording of data received; and
- ◆ maintenance of an enquiry service to provide on payment of a reasonable fee a copy of the plan of the relevant main.

5.225. The condition also requires that the obligations are fulfilled without restricting, distorting or preventing competition in the market for the provision of competition in connections under the provisions of Section 10 of the Gas Act.

5.226. There is currently no Designated Registrar of Pipes. The condition is included in Transco's existing GT licence, but requires a direction from the Authority, following consultation, in order for Transco to be obliged to comply with it. To date, no such direction has been made by the Authority.

Proposed changes

5.227. Ofgem is minded not to propose any modifications to this condition so that Standard Condition 33 will continue to apply to all GT licences including NTS and DN-GTs. As a result, Ofgem would retain the ability to designate any GT as the Designated Registrar of Pipes.

5.228. Ofgem has received representations during the course of the consultation process on DN sales that have recommended that the Authority should direct for this licence condition to become operative. Potentially, this could be within Transco's licence. Hence, Ofgem invites views on whether this licence condition should become operative and, if so, which party should be designated the Registrar of Pipes.

5.229. Ofgem otherwise welcomes respondents' views on its proposal not to amend Standard Condition 33.

Standard Condition 38 – Availability of Data Formats

Description

- 5.230. Where a licensee uses standard file formats for transferring data for any purpose set out in the licensee's Network Code between persons identified as appropriate persons to receive the data under the Network Code the licensee is required to make those standard file formats and associated definitions of data available free of charge to shippers and GTs for use in connection with their licensed activities.

Proposed changes

- 5.231. Ofgem considers that it will be necessary to amend Standard Condition 38 for NTS and DN-GTs to take account of the new arrangements proposed under the UNC. We consider that a modified version of Standard Condition 38 should be introduced as a Standard Special Condition in the licence of each of the NTS and DN-GTs in order to accommodate this new commercial regime. Standard Condition 38 would then be switched off in the NTS and DN-GT licences.
- 5.232. It is currently Ofgem's intention to propose these modifications as part of the section 8AA transfer process.
- 5.233. Ofgem welcomes respondents' views on its proposals to modify Standard Condition 38.

Amended Standard Condition 39 – Restriction on Use of Certain Information and the Independence of the Transportation Business

Description

- 5.234. Amended Standard Condition 39 prevents the flow of information between the transportation business, the trading business, and with effect from 12 July 2004, pursuant to the changes brought about through RGMA, the licensee's Meter-Related Services Business and Meter Reading Business.
- 5.235. The condition obliges the licensee to use its best endeavours to secure that no information related to, or derived from, its transportation business is disclosed for the purposes or benefit of its trading business, its meter related services

business, its meter reading business or any affiliate or related undertaking of the licensee. To ensure this, a number of restrictions have been implemented in relation to the way in which businesses are operated, including:

- ◆ restrictions on the communication of information to persons engaged in any trading business conducted by the licensee (including affiliates and any related undertakings of the licensee) or in the licensee's Meter-Related Services Business or Meter-Reading Business;
- ◆ restrictions on access by persons engaged in any trading business conducted by the licensee (including affiliates and any related undertakings of the licensee) or in the licensee's Meter-Related Services Business or Meter-Reading Business to:
 - ◆ premises or parts of premises occupied by persons engaged in the transportation business; and
 - ◆ recorded information relating to the transportation business; and
- ◆ the prevention (in so far as the licensee can require it) of any person who has ceased to be engaged in the transportation business from being engaged in such a business until the expiry of the appropriate period as defined in the condition.

5.236. In this licence condition the transportation business includes LNG storage arrangements but the Authority has the ability to omit these provisions through the procedures contained in Paragraph 5 of the condition.

Proposed changes

5.237. Ofgem considers that it will be necessary to retain the obligations contained in this condition in the NTS and DN-GT licences. Accordingly, it is proposed that the provisions of this Amended Standard Condition will be included in the NTS and DN-GT licences as a Standard Special Condition. As before, the designated Standard Condition will be introduced but will then be switched off immediately following the introduction of the new Standard Special Condition and Amended Standard Condition 39 would be taken out of the NTS and DN-GT licences.

- 5.238. As set out in the Authority's conclusions document on the offtake arrangements, the Authority is minded to require the legal separation of Transco's NTS and Transco's RDNs. Consideration will need to be given to what additional requirements will need to be put in place to support the structural separation that will be required between Transco's NTS and Transco's RDNs. As the conclusions document indicated, potential requirements might be, for instance, that the NTS is required to have a statement in place describing the practices, procedures and systems it has adopted to ensure no undue discrimination between RDN and IDN businesses.
- 5.239. This will need to be achieved either through modifications to this condition in the form of Special Conditions on the NTS and RDN-GT licensees or alternatively new Special Conditions. Ofgem would welcome respondents' views on these conditions including the degree of transparency that should be required with respect to compliance with such separation requirements.
- 5.240. Again, consideration will need to be given to the treatment of LNG storage assets. Ofgem has set out two alternatives earlier in this Chapter. Ofgem would welcome respondents' views on the treatment of LNG storage in the context of this licence condition.
- 5.241. Ofgem further considers that this condition, in conjunction with other conditions, may require further modifications to deal with any potential competition issues which may arise when the issues associated with the potential purchasers have been fully considered. For instance, this could involve the introduction of requirements modelled on those that apply to the electricity distributors⁴⁴. If such further modifications are required, for the avoidance of doubt, it will be Transco as the relevant licence holder which will be asked to consent to the proposed modifications. Notwithstanding this, Ofgem would of course welcome views on these competition issues, including, without limitation, the views of potential purchasers. It is likely, due to the timescales associated with Transco's proposed transaction, that these further modifications would be considered as part of the section 8AA process.

⁴⁴ *Separation of PES business: Review of C39 of the proposed new distribution licence. Decision Paper* Ofgem February 2002

5.242. It is currently Ofgem's intention to propose these modifications largely as part of the section 23 notice to be published in November 2004. However, we recognise that further work is needed and therefore that parts of these proposals may have to be considered at the section 8AA stage of the process.

5.243. Ofgem welcomes respondents' preliminary views on its proposals with respect to Amended Standard Condition 39.

Standard Condition 40 – Appointment of Compliance Officer

Description

5.244. The licensee is obliged to ensure that at all times it employs a competent person (the compliance officer) for the purpose of facilitating compliance with Standard Condition 39. The licensee is obliged to consult with the Authority before employing any such person and the compliance officer is required to be provided with such staff and facilities as he may reasonably be required to perform the tasks assigned to him. These include:

- ◆ establishing procedures to ensure that the precautions in paragraph 7 of Standard Condition 39 are effectively complied with;
- ◆ conducting investigations following shipper or supplier representations that certain elements of Standard Condition 39 may have been breached or that the procedures are not complied with or are defective;
- ◆ providing advice to directors and employees or any such person referred in Standard Condition 39 (7) to facilitate compliance with certain specified conditions; and
- ◆ providing information or advice regarding the procedures established under this condition to any shipper or supplier requesting it.

5.245. The licensee is also obliged to furnish to the Authority and publish in the form and manner directed by the Authority a report on the compliance officer's activities.

Proposed changes

- 5.246. Ofgem considers that it will be necessary to retain this obligation in the NTS and DN-GT licences. It will be necessary to consider the consequential amendments that will be necessary to this Standard Condition following the modifications that are likely to be proposed to Amended Standard Condition 39.
- 5.247. As discussed in relation to Amended Standard Condition 39, the Authority is minded to require the legal separation of Transco's NTS and Transco's RDNs. Ofgem is, however, not minded to put in place any separation requirements (either structural or legal separation) between DN companies under the same ownership. However, Ofgem would be minded to require separate regulatory accounts as indicated in its comments on Amended Standard Condition 30 (Regulatory Accounts). There may be other situations where further disaggregation of information may be required notwithstanding its position on separation. It will also be necessary for the Authority to consider any competition concerns which may arise out of the identity of any of the potential purchasers.
- 5.248. Again, as with Amended Standard Condition 39, consideration will need to be given in respect of LNG storage assets. Ofgem has set out two alternatives earlier in this Chapter. Ofgem would welcome respondents' views on the treatment of LNG storage in the context of this licence condition.
- 5.249. It is therefore likely that any modifications to Amended Standard Condition 39 will result in Standard Condition 40 being modified to a Standard Special Condition, potentially with further Special Conditions being included in the licences of Transco's NTS and RDN-GT licences. Standard Condition 40 would then be switched off in the NTS and DN-GT licences
- 5.250. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004. However, we recognise that further work is needed and therefore that these proposals may have to be considered at the section 8AA stage of the process.
- 5.251. Ofgem welcomes respondents' preliminary views on its proposals with respect to Standard Condition 40.

Standard Condition 41– Prohibition of Cross Subsidies

Description

- 5.252. This condition requires the licensee to procure that its transportation business does not give or receive any cross subsidy to or from any other business of the licensee or of an affiliate or related undertaking of the licensee.

Proposed changes

- 5.253. Ofgem has published a position paper on DN/DN separation setting out its preliminary decision not to require DN/DN legal separation. Ofgem currently considers that, when a licensee conducts more than one DN business, this condition should ensure that each DN is operated independently without any cross subsidy from other DNs within the same legal entity. Ofgem invites respondents' views on this issue and on any additional measures that respondents consider necessary with respect to enhancing transparency for comparative regulatory purposes.
- 5.254. Ofgem is currently minded not to propose any modifications to this condition so that Standard Condition 41 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.255. Ofgem welcomes respondents' views on its proposal not to modify Standard Condition 41.

Amended Standard Condition 45 – Undertaking from Ultimate Controller

Description

- 5.256. Amended Standard Condition 45 sets out the requirement on the licensee to obtain a legally enforceable undertaking from each and every person who is an ultimate controller of the licensee in the form specified by the Authority, that the ultimate controller will:
- ◆ refrain from any action; and
 - ◆ procure that any person whom it controls will refrain from any action,

which would then be likely to cause the licensee to be in breach of any of its obligations under the Gas Act or licence. Such an undertaking is required to be obtained within seven days of a person becoming an ultimate controller and is required to remain in force as long as such person remains an ultimate controller.

5.257. The condition also requires the licensee to deliver evidence of this undertaking to the Authority and to inform the Authority immediately if the directors of the licensee become aware that the undertaking has ceased to be legally enforceable or its terms have been breached and to comply with any direction by the Authority to enforce such undertaking.

5.258. In addition, save with the written consent of the Authority, the condition prohibits the licensee from entering into arrangements with an ultimate controller or any subsidiary of an ultimate controller (other than subsidiaries of the licensee itself) when an undertaking is not in place in relation to that ultimate controller or if there is unremedied breach of such undertaking or the licensee is in breach of an Authority direction.

5.259. Transco's existing licence condition is an Amended Standard Condition. The amendments provided for an alternative definition of ultimate controller to that set out in the Standard Condition. The definition has subsequently reverted to the standard definition. As such this condition is now in the standard form.

Proposed changes

5.260. Ofgem is therefore currently minded to adopt the standard form of Standard Condition 45 in all NTS and DN-GT licences i.e. Standard Condition 45 will apply to all GT licences including NTS and DN-GTs.

5.261. Ofgem welcomes respondents' views on its proposals with respect to Standard Condition 45.

Amended Standard Condition 47– Indebtedness

Description

5.262. This condition prevents the licensee from incurring inappropriate indebtedness or giving any form of security or guarantee unless it is on an arm's length basis,

on normal commercial terms and for permitted purposes and where relevant, in accordance with Standard Condition 29 (disposal of assets). Otherwise, new (i.e. all but “pre-relevant date”⁴⁵) indebtedness, without the prior written consent of the Authority is prohibited.

5.263. The condition requires the prior written consent of the Authority for transfers, leases etc, of any asset, right, sum or benefit etc to any affiliate or related undertaking unless made on an arm’s length basis on normal commercial terms, and, where applicable, in compliance with the payment condition except for the following:

- ◆ dividends, or other distributions out of distributable reserves;
- ◆ repayment of capital;
- ◆ payment properly due for goods services or assets;
- ◆ transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm’s length basis, on normal commercial terms and in compliance with the payment condition;
- ◆ repayment of or payment of interest on a loan that is not prohibited;
- ◆ payments for group corporation tax relief or surrender of advance corporation tax; or
- ◆ a transfer or acquisition of shares or other investments in compliance with Special Condition 2 (Restriction on Activity and Financial Ring Fencing).

5.264. The payment condition requires that the transaction is paid in full at initiation unless the counter-party has an investment grade credit rating or there is a full and unconditional guarantee from a guarantor which has and maintains an investment grade credit rating.

5.265. Transco’s existing licence condition is an Amended Standard Condition. The amendments reflect, amongst other things, the fact that the provisions within the

⁴⁵ The relevant date is defined in Transco’s licence as 13 December 1999, which is the date under which

Standard Condition 47 relating to Cross-Default Obligations are contained within Special Condition 5 within Transco's existing GT licence.

Proposed changes

- 5.266. Ofgem is currently minded to revert to the standard form of Standard Condition 47 in all NTS and DN-GT licences with the associated standard Cross-Default Obligation provisions. Ofgem consents to Transco regarding pre-relevant date indebtedness and Cross-Default Obligations will, however, be preserved to the extent these remain outstanding. As a result, Special Condition 5 will no longer be needed.
- 5.267. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.268. Ofgem welcomes respondents' views on its proposals with respect to Amended Standard Condition 47.

Standard Condition 48 – Last Resort: Payment Claims

Description

- 5.269. Standard Condition 48 sets out the circumstances under which the licensee is required to increase its transportation charges in order to compensate any gas supplier which claims for losses that it has incurred in complying with a last resort supply direction. Where the licensee receives from a claimant supplier a valid claim for a last resort supply payment, it is required to make a consequential increase in its transportation charges to such an extent as it reasonably estimates to be appropriate to secure that such consequential increase in its revenue equals the specified amount of the claim by the supplier. Payment to the supplier is made on quarterly or monthly instalments. The condition stipulates the interest payments and any increase in transportation charges in the following year in the case of a short fall in payments. It also outlines the reduction of charges taking account of interest on excess charges in the previous year.

the Scheme of Arrangements became effective under section 425 of the Companies Act 1985.

- 5.270. The final decision on whether the estimates are reasonable lies with the Authority. The arrangements with shippers must allow for charges to be varied. The price control is unaffected by this condition. The condition includes an obligation to produce a statement of increases or decreases in charges showing the aggregate changes to revenues received and payments made. The condition also outlines the arrangements to apply in the event that there is more than one last resort payment claim.

Proposed changes

- 5.271. Ofgem is currently minded not to propose any modifications to this condition so that Standard Condition 48 will continue to apply to all GT licences including NTS and DN-GTs.
- 5.272. Ofgem welcomes respondents' views on its proposals with respect to Standard Condition 48.

Special Conditions

Special Condition 1 – Interpretation and Construction

Description

- 5.273. Special Condition 1 sets out some of the rules for the interpretation and construction of the Special Conditions. Unless the context requires otherwise words and expressions used in the Standard Conditions of the licence have the same meaning in Special Conditions. It should be noted that some of the Special Conditions also set out particular definitions or interpretations which are specific to the condition in question.

Proposed changes

- 5.274. Depending on the outcome of the proposals set out in this document for both Standard Conditions and Special Conditions, it is likely that there will need to be a new Standard Special Condition for both NTS and DN-GT licensees dealing with issues of definition, interpretation and construction. In addition, it may be necessary to have further definitions and interpretation contained within Special Conditions applicable to the individual licensees.

- 5.275. The definitions to be included in these new conditions will need to follow the restructuring of the licence and the commercial regime as a whole and it is therefore not possible to provide any further detail of these proposals at this time.
- 5.276. It is currently Ofgem's intention to propose a significant number of these modifications as part of the section 23 notice to be published in November 2004. However, further amendments may need to be incorporated as part of the section 8AA transfer process.
- 5.277. Ofgem welcomes respondents' views on these proposals.

Special Condition 2 – Restriction on Activity and Financial Ring-Fencing

Description

- 5.278. This condition prohibits the licensee from undertaking any business other than the Transco Business, other than business for which the Authority has given express consent, or "de minimis" business. The condition defines what de minimis business is and additionally sets out the limitations on the de minimis business which must be complied with.
- 5.279. The permitted Transco Business includes the following:
- ◆ Transportation and LNG Storage business;
 - ◆ the Metering Business; and
 - ◆ the Meter Reading Business.
- 5.280. The condition provides that LNG Storage may be excluded from the scope of the condition if the Authority so directs.
- 5.281. The condition states that the licensee shall not, without the written consent of the Authority, hold or acquire shares or other investments of any kind except:

- ◆ in a company whose sole activity is to carry on a business for a “permitted purpose” (i.e. within the scope of the permitted purpose set out in Amended Standard Condition 32)⁴⁶;
- ◆ in a company that is a subsidiary of the licensee which has been incorporated solely to raise finance for the ‘Transco Business’;
- ◆ shares acquired in a company which has transferred to it an activity that is to cease or ceases to fall within Transco’s “permitted purpose” and includes any other business or activity of the licensee or a subsidiary of it immediately before the relevant date (the date which the Scheme of Arrangement⁴⁷ became effective) which it continues to run; or
- ◆ investments acquired in the normal and usual course of the licensee’s treasury operations subject to the licensee maintaining in force internal controls which comply with best corporate governance practice as required for listed companies in the UK.

5.282. Subject to the above, affiliates in which the licensee does not hold shares or investments may conduct or carry on any business or activity. Additionally the licensee may hold shares or perform supervisory or management functions of a company in which it holds an interest, consistent with its licence. The licensee may also perform a supervisory or management functions of a holding company in respect of any subsidiary. The Authority may also give its written consent to the licensee carrying on any business or conducting any activity.

5.283. The condition also imposes a reasonable endeavours obligation on the licensee to cease to conduct and carry on a business or activity which it was conducting or carrying on at the relevant date and which it would otherwise be prohibited by this condition from conducting. The licensee must submit to the Authority by 31 March each year, a report on the endeavours it has made in the last 12 months to cease to conduct or carry on these businesses or activities but so long as the licensee makes reasonable endeavours to cease to carry on those activities, it may continue to conduct them.

⁴⁶ As defined in Amended Standard Condition 32

⁴⁷ These are defined in Special Condition 1

- 5.284. Nothing in this condition prevents the licensee or an affiliate or related undertaking in which the licensee holds shares or other investments conducting de minimis business.

Proposed changes

- 5.285. It is proposed that this Special Condition be removed from Transco's existing GT licence and Standard Condition 43 used in its place. It is the intention that Transco's "permitted purpose" would be as defined in Amended Standard Condition 32, which will become a Standard Special Condition as explained earlier. However, it is recognised that it may be necessary to supplement Designated Standard Condition 43 with one or more Special Conditions.
- 5.286. Ofgem proposes to retain the definition of "investment" as in paragraph 4(d) of Special Condition 2 in a new Standard Special Condition such that, for the purposes of calculating an "investment", account is taken of income received by the licensee in respect of such investment. It is proposed, in due course, to modify the equivalent condition in all electricity distribution and transmission licences to bring these into line. Further amendments may also be required. Special Condition 2 would be modified out of the licence.
- 5.287. The proposed change will remove the freedom for Transco to hold shares or other investments to which it has transferred activities that are not, or have ceased to be, a "permitted purpose". Ofgem understands that Transco does not presently hold any such shares or investments.
- 5.288. It is currently Ofgem's intentions to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.289. Ofgem welcomes respondents' views on its proposals to remove this condition and reinstate Standard Condition 43 together with such other Standard Special Conditions as may be required.

Special Condition 3 – Availability of Resources

Description

- 5.290. This condition states that the licensee shall ensure that it has sufficient resources to carry out properly and efficiently its Transportation and LNG Storage Business

and comply with all obligations of the licensee. The licensee is also obliged to submit to the Authority, on 30 June each year, a board approved certificate relating to the adequacy of its resources to carry on the activities authorised by the licence in the ensuing 12 month period and a statement of the factors taken into account in providing the certificate. This condition sets out the options and possible forms for this certificate (sufficient resources/sufficient resources with caveat/insufficient resources). The licensee is also required to use its best endeavours to submit an auditors' report in relation to the certificate and statement.

- 5.291. The licensee is obliged to inform the Authority in writing immediately of any change in the reasonable expectations expressed in the certificate.
- 5.292. This condition also restricts the ability of directors of the licensee to make, declare or recommend distributions other than in compliance with financial ring-fencing criteria. This condition also allows the Authority to exclude LNG storage from the scope of the obligations in this condition.

Proposed change

- 5.293. Ofgem considers that this licence condition should apply to all NTS and DN-GTs. A similar condition is standard in all electricity distribution and transmission licences. Therefore it is proposed that the licence condition will become a Standard Special Condition. Ofgem welcomes respondents' views on its proposals in relation to Special Condition 3.

Special Condition 4 – Investment Grade Credit Rating as Issuer of Corporate Debt

Description

- 5.294. This condition obliges the licensee to use all reasonable endeavours to maintain an investment grade credit rating.
- 5.295. While the condition is based on Standard Condition 46 it is different in two respects:

- ◆ it includes a definition of corporate debt; and

- ◆ has been modified to reflect changes in Amended Standard Condition 47 and Special Condition 5 (Cross-Default Obligations).

Proposed change

- 5.296. Ofgem is minded to remove this condition and reinstate Standard Condition 46 as designated by the Secretary of State for all GT licences including NTS and DN-GTs. Ofgem proposes to revert, where possible, to the designated Standard Conditions on financial issues such as this and, therefore, the amendments to the designated Standard Condition are no longer required.
- 5.297. Ofgem is considering, as an alternative, whether a Standard Special Condition should be introduced to include Fitch, Dominion or other rating agencies as well as Standard & Poor's and Moody's. A similar modification is being considered for all electricity distribution and transmission licences.
- 5.298. Ofgem is also considering whether any issues resulting from the DN licence drafting process should be taken into account (the modification could occur around February 2005).
- 5.299. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.
- 5.300. Ofgem welcomes respondents' views on its proposals for Special Condition 4.

Special Condition 5 – Cross-Default Obligations

Description

- 5.301. This condition prohibits the licensee from entering into or continuing with any cross-default obligations without the prior consent of the Authority. A cross-default obligation is defined by the condition, and includes a term of any agreement or arrangement under which the licensee's liability to pay or repay any debt or other sum, or do anything under the terms of an agreement or arrangement to which the licensee is a party arises, or is increased or accelerated or is capable of such, by reason of the default of a party other than the licensee itself (or its wholly owned and controlled subsidiaries carrying on activities within the licensee's permitted purpose).

5.302. Prohibited activities incorporating cross-default obligations⁴⁸ include:

- ◆ entering into an agreement or commitment incorporating a cross default obligation; or
- ◆ continuing or permitting to remain in effect an agreement or an arrangement which contains a cross default obligation which existed on the Relevant Date except for certain limited exceptions.

5.303. The condition does not prevent the licensee giving any guarantee permitted by, and compliant with, Amended Standard Condition 47.

5.304. It also addresses the issue of the treatment of certain cross default obligations to which the Authority has given consent allowing the licensee to permit these to remain in effect on certain terms including matters such as procuring and enforcing indemnities.

Proposed changes

5.305. Standard Condition 47 incorporates a prohibition on cross-default obligations. Ofgem does not consider that these exceptions continue to be appropriate. As Ofgem proposes to revert where possible to designated Standard Conditions on financial ring-fencing issues such as this, this condition will not be repeated in GT licences in the future. Ofgem is minded to revert to Standard Condition 47 for both NTS and DN-GTs, and as a result, Special Condition 5 will no longer be needed. Ofgem consents to Transco regarding pre-relevant date Cross-default Obligations will, however, be preserved to the extent that these remain outstanding.

5.306. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.

5.307. Ofgem welcomes respondents' views on its proposals to remove this condition and reinstate Standard Condition 47 as designated by the Secretary of State.

Special Condition 9D – Restriction of Prices for LNG Storage Services

Description

- 5.308. This condition sets out the charges which the licensee may apply for the supply of LNG storage services at certain sites on the NTS network for 1999, 2000 and subsequent formula years. The licensee may not deviate from those charges except with the Authority's prior written consent. If these values are complied with, Standard Conditions 4 and 4A are deemed to have been complied with in respect of the named LNG storage facilities.
- 5.309. The condition contains a disapplication procedure. The licensee may apply to disapply the condition in writing. If the Authority does not refer the modification of this condition to the Competition Commission and so long as the licensee has not withdrawn the disapplication request, the licensee may deliver written notice to the Authority terminating the condition 12 months after the date of the notice. Similarly, if the application of the condition is referred to the Competition Commission and the Competition Commission reports that the disapplication of the condition is not against public interest, the licensee can give notice terminating the application of the condition.

Proposed changes

- 5.310. Ofgem would refer respondents to its comments relating to the treatment of LNG generally set out in relation to Amended Standard Condition 4 above. Pending the outcome of this consultation and whether LNG should be treated as an NTS only or an NTS and DN activity, Ofgem does not consider that it can propose changes to this condition at this stage.
- 5.311. Ofgem welcomes respondents' views on the treatment of LNG within the new structure of the licence.

Special Condition 17 – Operational Guidelines for Balancing

Description

- 5.312. The condition requires the establishment of operational guidelines consistent with the Network Code specifying the particular balancing measures that the licensee expects to take. The condition also provides for the publication and modification of the guidelines and the preparation of reports to the Authority.

These guidelines need periodic publication and copies should be provided upon request.

Proposed changes

- 5.313. It is proposed that this condition will be deleted and be superseded by the provisions of the existing Special Condition 27 which provide for the establishment of a System Management Principles Statement.
- 5.314. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.315. Ofgem welcomes respondents' views on its proposals to remove this Special Condition.

Special Condition 18 – Conveyance to Independent Systems

Description

- 5.316. Special Condition 18 relates to the conveyance of gas to independent systems. The condition requires that the average charge for the conveyance of gas to these independent systems should be no more than the average charges for all conveyance to premises in Great Britain supplied with that type of gas at a similar rate.

Proposed changes

- 5.317. Ofgem published an open letter on 6 August indicating that it will be considering issues raised by the network sales for this condition and inform interested parties of its conclusions. Ofgem intends to progress the issues associated with Special Condition 18 separately to this consultation.
- 5.318. It is anticipated that any amendments considered necessary would be introduced as part of the section 8AA transfer process.

Special Condition 19 – Emergency Services to or on Behalf of Another Gas Transporter

Description

- 5.319. This condition provides that the Authority can direct, after consultation with the HSE, that the licensee offer terms to enter into an agreement with other gas transporters (or applicants for gas transporter licences) for the provision of emergency services where a major loss of supply has occurred. Such agreement must be on reasonable terms and may provide for the licensee to recover all costs reasonably related to the emergency service provision, a reasonable commercial profit and appropriate indemnities against third party claims.
- 5.320. Nothing in this condition requires the licensee to employ more staff or equipment for this purpose than it would otherwise employ for the purposes of its Transportation and LNG Storage Businesses.
- 5.321. Any dispute over the terms of any offer may be referred to the Authority for determination by either the licensee or the person named in the direction.

Proposed changes

- 5.322. Ofgem considers that this licence condition should apply to all NTS and DN-GTs. Therefore it is proposed that the licence condition is included in all NTS and DN-GT licences as a Standard Special Condition. Ofgem welcomes respondents' views on this.
- 5.323. Through the workgroup process Ofgem has received representations from a number of parties concerning the provision of emergency services. In particular, it has been suggested that the terms of this condition could be broadened, or a new condition introduced, to cover emergency services between gas transporters in circumstances other than when a major loss of supply has occurred. These issues are considered in the next Chapter on proposed new licence conditions.
- 5.324. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.325. Ofgem welcomes respondents' views on these proposals.

Special Condition 23 – Provision of Meter and Meter Reading Services

Description

- 5.326. This condition requires Transco to provide the terms on which it shall provide metering services direct to the relevant supplier. It has been amended in Transco's licence as part of Ofgem's RGMA reforms which came into effect on 12th July 2004 so that it applies to the provision of services to suppliers and not as was previously the case shippers. This obligation only applies to Transco and does not apply to the IGTs.
- 5.327. The introduction of this condition will help to ensure that, in the future, where it becomes evident that changes to the RGMA Baseline are necessary to reflect the development of the gas metering market, these cannot be unreasonably refused by Transco. It will therefore help to ensure that requests made by suppliers in relation to improvements in metering service provision are dealt with by Transco on reasonable terms.
- 5.328. The condition also requires the licensee to provide suppliers with terms that specify the date by which the services required shall be provided, the charges to be paid for services (in a format that allows referral to the statements) and any other appropriate details. These terms should be provided within 28 days of receipt of an application containing all necessary information.
- 5.329. The licensee is obliged to provide terms to the supplier as soon as practicable and no later than 28 days after receipt of an application containing all such information as may be reasonably required. These statements should be reviewed on at least an annual basis to ensure their continuing accuracy.
- 5.330. Except in so far as the Authority agrees, the licensee shall enter into agreements with the supplier for:
- ◆ gas meters;
 - ◆ metering services other than provision of gas meters (i.e. services relating to the operation of the meter); or
 - ◆ meter reading services.
- 5.331. The condition also requires the licensee to produce statements in a form approved by the Authority setting out the basis for charges and the information relating to the other terms that apply to the provision of each service. This information must be set out in such a way as to enable a supplier to make a

reasonable estimate of the charges and terms to which it would be subject. The statement should include a schedule of charges and an explanation of the methods and principles of calculation. This statement must be reviewed and updated and copies provided to any supplier who request the same and may make a charge for this (which must not exceed the level specified in a direction by the Authority).

- 5.332. Under the condition, the Authority may issue a direction relieving the licensee of certain of its obligations to the extent specified in the direction.

Proposed changes

- 5.333. This condition is currently a Special Condition applying only to Transco. Transco has proposed that metering obligations should be placed in the licences of both the NTS licensee and the DN licensees. Ofgem therefore proposes that the special condition contained in Transco's licence should become a Standard Special Condition applicable to all licences.
- 5.334. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.335. Ofgem welcomes respondents' views on its proposals regarding this condition.

Special Condition 25A – Assignment of Licence

Description

- 5.336. Special Condition 25A requires that the licensee may only transfer its licence (either in whole or in relation to part of an authorised area or any specified pipeline system) if it:
- ◆ complies with the procedure in section 8AA of the Gas Act; and
 - ◆ obtains the prior written consent of the Secretary of State.

Proposed changes

- 5.337. Ofgem proposes that this condition should become a Standard Special Condition contained in all NTS and DN-GT licences.

5.338. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

5.339. Ofgem welcomes respondents' views on its proposals to amend this condition.

Special Condition 26 – Prohibited procurement activities

Description

5.340. This condition requires that:

- the licensee; or
- the licensee shall procure that any affiliate or related undertaking,

shall, not on its own account or that of the affiliate or related undertaking purchase, enter into or otherwise acquire transportation commodities, gas or gas derivatives with the intention of selling, assigning or disposing of such assets to third parties without the consent of the Authority.

5.341. The prohibition in the condition does not apply where such purchase or acquisition occurs for the purpose of facilitating balancing management and constraint management where the transaction is conducted on economic and efficient terms and facilitates the economic and efficient operation of the transportation system.

5.342. The condition provides for particular definitions of matters such as balancing management, derivatives and other conditions.

Proposed changes

5.343. In May 2004, Ofgem released a decision document concerning the assignment of roles and responsibilities between the NTS and DNs⁴⁹. In this document the Authority's decision to adopt an active DN approach was explained. The Authority additionally confirmed its view that in the event of any DN Sale it was critical that the NTS retained responsibility for the role of residual energy balancing.

⁴⁹ *National Grid Transco – potential sale of gas distribution network businesses, Allocation of roles and responsibilities between transmission and distribution networks*, Ofgem, May 2004

5.344. In light of the conclusions set out in this document, Ofgem's initial proposals are that the current Special Condition 26 should be split as follows:

- ◆ **A Special Condition is placed in the NTS–GT licence:** allowing the purchase of gas or gas derivatives for the purpose of facilitating balancing management where the transaction is conducted on economic and efficient terms and facilitates the economic and efficient operation of its system. Ofgem invites views on this proposal; and
- ◆ **A Standard Special Condition is placed in the NTS and DN–GT licences:** allowing the purchase of transportation commodities, gas or gas derivatives for the purpose of facilitating constraint management where the transaction is conducted on economic and efficient terms and facilitates the economic and efficient operation of its system. Ofgem invites views on this proposal.

5.345. Ofgem additionally considers that the definitions in the condition will need to be carefully reviewed to support the split in the roles and responsibilities between the NTS and DNs in the event of any DN Sale.

5.346. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

5.347. Ofgem welcomes respondents' views on these proposals.

Special Condition 27 – Licensee's procurement and use of system management services

Description

5.348. This condition requires the licensee to operate the NTS in an efficient, economic and co-ordinated manner and prohibits undue discrimination or undue preference in procurement or use of system management services. The condition additionally places obligations on the licensee to produce various reports and statements for the Authority. The condition sets out the manner in which these reports and statements must be produced.

Proposed changes

5.349. This condition will need to be split in a manner which tracks the treatment of constraint management and balancing in Special Condition 26.

5.350. Ofgem's initial proposal is that Special Condition 27 should be split such that:

- ◆ A Special Condition is placed in the NTS-GT licence to operate its system in an efficient, economic and co-ordinated operation manner and prohibits undue discrimination in procurement or use of system management services. Ofgem considers that the reporting requirements should be consistent with those set out in Standard Condition 27; and
- ◆ A Standard Special Condition is placed on DN-GT licences to operate DNs in an efficient, economic and co-ordinated operation manner and prohibits undue discrimination in procurement or use of system management. Ofgem considers that the reporting requirements need to be further considered for the DN businesses both in terms of ensuring that the reporting requirements and costs are targeted appropriately given the split of roles and responsibilities. For example, it would be clearly inappropriate for any DN system management costs to feed into imbalance cash out.
- ◆ Ofgem additionally considers, and invites views on, whether a further condition will be required that obliges licensees not to prejudice each others' systems. This could be similar to the existing conditions in shippers' licences (e.g. Standard Condition 3). If so, we consider that this should be a Standard Special Condition.

5.351. Ofgem, therefore, is initially proposing to split Special Condition 27 between NTS and DNs according to responsibilities.

5.352. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

5.353. Ofgem welcomes respondents' views on these proposals.

Special Condition 28A – Revenue restriction definitions

Description

5.354. This condition defines a number of terms in the revenue restrictions.

Proposed changes

5.355. This condition will need to be amended and split into Special Conditions setting out the definitions which are relevant for each DN licence and the NTS licence.

5.356. Ofgem therefore proposes to split this condition into Special Conditions for NTS and DN-GT licensees.

5.357. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

5.358. Ofgem welcomes respondents' views on its proposals to split this condition into Special Conditions for NTS and DN-GT licensees.

Special Condition 28B – Restriction of revenue in respect of the NTS Transportation Owner Activity, Distribution Owner Activity and NTS System Operation Activity.

Description

5.359. This condition defines the price controls and incentive applicable to Transco (other than those LNG and metering activities which are subject to separate price controls).

Proposed changes

5.360. This condition will need to be amended and split into Special Conditions setting out the price controls and incentives which are relevant for each DN licence and the NTS licence. Ofgem therefore proposes to split this condition into Special Conditions for NTS and DN-GT licensees. It may also be necessary to amend this condition to reflect any necessary changes to the price control treatment of shrinkage arrangements.

5.361. In August 2004, Ofgem issued its conclusions on the offtake and interruption arrangements which will apply in the event of the sale of DNs by NGT. One of the proposals was to introduce new incentive schemes on both the NTS and DNs to support these arrangements. Whilst the form and scope of these

incentive schemes are being developed, Ofgem has considered the issue of the duration of the DN incentives. In August 2004, Ofgem published an open letter explaining its initial position that these incentive schemes would be of one year's duration. Ofgem will fully consult on these incentive schemes including the proposals on the duration of the schemes.

- 5.362. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004. However, it may be necessary, particularly with respect to new incentive schemes, that further amendments may be considered necessary as part of the section 8AA transfer process.
- 5.363. Ofgem welcomes respondents' views on its proposals to split this condition into Special Conditions for NTS and DN-GT licensees, and to amend the condition to reflect any necessary changes to the price control treatment of shrinkage arrangements.

Special Condition 29 – Allocation of revenues and costs for calculation under price control

Description

- 5.364. This condition sets out the licensee's obligations regarding the allocation or attribution of revenues, costs, assets and liabilities by the licensee in order to calculate values referred to in Special Condition 28B.

Proposed change

- 5.365. This condition will again need to be tailored according to the activities conducted by the licensee. The provisions of this condition should be contained in a Special Condition for each licensee linked to the revenue restriction condition and amended at paragraph 2 to reflect the relevant activities of each licensee.
- 5.366. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004. However it may be necessary, particularly with respect to new incentive schemes, that further

amendments may be considered necessary as part of the section 8AA transfer process.

- 5.367. Ofgem welcomes respondents' views on its proposals to split this condition into Special Conditions for NTS and DN-GT licensees.

Special Condition 30 Supplementary provisions of the revenue restrictions

Description

- 5.368. This condition sets out activities that can be treated as excluded services and defines charges or proportions of charges which can be treated as excluded services. These include last resort payment claims, supplemental charges, emergency service charges, charges relating to gas illegally taken or works at connection points. Other services outside the normal activity or for the specific benefit of third parties can also be excluded services, if approved by the Authority. The Authority can direct that previously excluded services should no longer be treated as such.

Proposed change

- 5.369. The provisions of this condition should be contained in a Special Condition for each licensee linked to the revenue restriction condition and amended to reflect the relevant activities of each licensee.
- 5.370. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004. However it may be necessary, particularly with respect to new incentive schemes, that further amendments may be considered necessary as part of the Section 8AA transfer process.
- 5.371. Ofgem welcomes respondents' views on its proposals to split this condition into Special Conditions for NTS and DN-GT licensees.

Special Condition 31 – Restriction of prices in respect of tariff capped metering activities

Description

- 5.372. This condition sets tariff caps for metering activities which can be increased in line with the Retail Prices Index, with a claw back for 2005.
- 5.373. This condition specifies the maximum, indexed tariff cap values for the charges for different metering activities.
- 5.374. The licensee may depart from the published statement of charges in respect of tariff-capped metering activities after requesting consent from the Authority to do so (or if 90 days elapse without an Authority direction denying the request). Following the implementation of RGMA, from 12 July 2004, the circumstances in which the licensee may be permitted to apply to the Authority for consent to depart from its published statement of charges were extended. In keeping with the modification implemented within Special Licence Condition 23 requiring Transco to provide metering services on reasonable terms, Transco is permitted to apply for consent to depart from its published statement of charges where it considers this departure to be necessary to comply with its obligations under Special Licence Condition 23.
- 5.375. Disapplication of the maximum tariff caps may occur if a written disapplication request to the Authority is approved. The Authority can choose to refer this to the Competition Commission.

Proposed change

- 5.376. Ofgem proposes to introduce a Standard Special Condition contained in all NTS and DN-GT licences. In this respect both the NTS and the DN-GT will be required to comply with the conditions contained in its price control which relate to the provision of metering services.
- 5.377. Further consideration will need to be given to the apportionment of the tariff cap.
- 5.378. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.379. Ofgem welcomes respondents' views on its proposals not to amend this condition and to maintain this condition as a Standard Special Condition contained in all NTS and DN-GT licensees.

Special Condition 32 – Non-discrimination in the provision of metering activities

Description

- 5.380. This condition requires avoidance of undue discrimination in the provision of metering activities. In accordance with paragraph 5 of Standard Condition 23, charges should not differ between Shippers except to reflect reasonable cost differences. Furthermore, in setting charges licensees should not restrict, distort, or prevent competition in the supply or conveyance of gas.
- 5.381. Charges should only be levied for activities for which the shipper has contracted.

Proposed change

- 5.382. Ofgem proposes that this condition is a Standard Special Condition contained in all NTS and DN-GT licences.
- 5.383. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.384. Ofgem welcomes respondents' views on its proposals not to amend this condition and to maintain this condition as a Standard Special Condition contained in all NTS and DN-GT licences

Special Condition 33 – Information to be provided to the Authority in connection with the transportation system revenue restriction

Description

- 5.385. This condition requires the licensee to provide statements to the Authority incorporating the information that it set out in specified tables. In each case, this table specifies the piece of information, the period over which it should be provided, the frequency of provision and the reporting deadline for its provision. Where information is derived from application of a licence formula, the component parameters of the formula should also be reported. All revenue information provided must comply with the requirements of Special Condition 29 (Allocation of revenue and costs for calculations under the price control).

Proposed change

- 5.386. The condition will need to be split appropriately for the NTS and DN. The condition will need to ensure information is provided for each network and separated out for each authorised area of each DN network (including those retained by Transco). This means that there will need to be separate tables for each DN with the references to the price controls appropriately adjusted.
- 5.387. As such, the condition will be separated into Special Conditions for each NTS and DN-GT licence.
- 5.388. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004. However, it may be necessary, particularly with respect to new incentive schemes, that further amendments may be considered necessary as part of the section 8AA transfer process.
- 5.389. Ofgem welcomes respondents' views on its proposals to split this condition into Special Conditions for each NTS and DN-GT licences.

Special Condition 34 – Licensee's methodology for determining incremental entry capacity volumes

Description

- 5.390. This condition requires licensees to prepare and submit, before 1 July in each formula year (or if directed by the Authority), an audited incremental entry capacity release methodology statement in a form approved by the Authority consistent with the licensee's duties setting out the methodology by which it will determine whether to make incremental entry capacity available for sale to the shippers. This statement must be accompanied by a statement from the licensee's auditors confirming that they have carried out an investigation and giving their opinion on whether the development is consistent with the licensee's duties.
- 5.391. The condition sets out the process for revision of the statement including consultation and specified the role of the Authority in this regard. It also provides for publication of the statement.

Proposed change

- 5.392. As the above issues only concern the NTS, Ofgem proposes to maintain this condition as a Special Condition contained in the licence of the NTS operator only.
- 5.393. A corresponding provision will be required for NTS exit capacity volume.
- 5.394. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.395. Ofgem welcomes respondents' views on these proposals.

Special Condition 35 – NTS performance reporting

Description

- 5.396. This Special Condition provides for the collection of information and appropriate degree of accuracy by the licensee to monitor the environmental performance of the NTS, and facilitate the development of an expenditure monitoring framework.
- 5.397. The condition provides for the establishment of systems, processes and procedures for measurement and recoding of data and the information provided and the underlying systems, processes and procedures should be made available for scrutiny by an Authority nominee and the licensee should cooperate fully in facilitating such a review. This includes providing full access to management and staff, premises, documents, systems and assets.
- 5.398. The Authority may amend the specified information subject to providing justification for the amendments and allowing 28 days for representations to be made. Where the amendment relates to a requirement in the regulatory instructions and guidance to provide any specified information it should be implemented with respect to the charging review date, providing that it occurs in more than 12 months time, unless an alternative date or period of notice is agreed with the licensee.

Proposed change

- 5.399. Ofgem is minded to maintain this condition as a Special Condition contained in the licence of the NTS operator.
- 5.400. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.
- 5.401. Ofgem welcomes respondents' views on these proposals.

Special Condition 36 – LDZ incentive scheme and performance reporting

Description

- 5.402. This condition defines the incentive and performance measures applicable to Transco's LDZ network.

Proposed change

- 5.403. Ofgem proposes to maintain this condition as a Special Condition contained in DN licences.
- 5.404. Ofgem welcomes respondents' views on the proposal not to amend this condition.

Special Condition 37 – Exit code statement

Description

- 5.405. This condition requires the preparation and submission of an exit code statement on 30 June in each formula year. Except to the extent specified by the Authority, this exit code should provide:

- ◆ A description of the services provided to the NTS Transmission Operator (TO) activity and/or the NTS System Operator (SO) activity by the Distribution Network transportation activity; and the Distribution Network transportation activity by the NTS TO activity and/or the NTS SO activity in the previous formula year; and

- ◆ details of any revenue received or charges made by the LDZ transportation activity from the NTS TO activity and/or NTS SO activity; and by the NTS SO activity and/or the NTS TO activity from the Distribution Network transportation activity in respect of each of the services described above in the previous year⁵⁰.

Proposed change

- 5.406. Ofgem expects that this condition will change with the introduction of the UNC/Offtake Code and will require amendment to reflect activities being conducted by the separate licensees.
- 5.407. Ofgem proposes to maintain this condition as a Special Condition for each licensee reflecting the respective responsibilities of each.
- 5.408. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004, although further changes will be necessary as part of the section 8AA process to reflect the revised commercial regime.
- 5.409. Ofgem welcomes respondents' views on these proposals.

Special Condition 38 – Restriction on Use of Information deriving from the EnMo Business

Description

- 5.410. The licensee is required to procure from each ultimate holding company of the licensee which is also the ultimate holding company of EnMo, a legally enforceable undertaking in favour of the licensee, that the ultimate holding company shall use its best endeavours to ensure that no EnMo confidential information (as defined) shall be disclosed or otherwise come into the possession of the licensee directly or indirectly from an EnMo source. Such an undertaking must be provided within 7 days of that company becoming the relevant ultimate holding company. Any breach of the undertaking is a breach by the licensee. The condition further requires that where the licensee does come into

⁵⁰ All such terms being defined in the licence.

possession of EnMo confidential information it must treat it as confidential and ensure that it shall not be used for the purpose of or in connection with the management or operation of the Transco Business.

- 5.411. The licensee shall provide evidence to the Authority that it has complied with this obligation, and inform the Authority immediately if the undertaking is no longer enforceable or is breached. Furthermore, the licensee shall comply with any direction from the Authority to enforce such an undertaking.

Proposed change

- 5.412. This provision is no longer relevant since the EnMo business has been disposed of by NGT with the consequent result that there is no longer a company which is the ultimate holding company of both Transco and EnMo. As such, Ofgem proposes to delete this condition and it will not, therefore, appear in the licences of any GT in the future.

- 5.413. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

- 5.414. Ofgem welcomes respondents' views on the proposal to delete this condition.

Special Condition 39 – Charging of Gas Shippers – Domestic Infill Premises

Description

- 5.415. This condition provides that where the licensee makes charges in accordance with Amended Standard Condition 4, the licensee may include a maximum surcharge of 0.3412 p / kWh of gas transported on 1 January 2004, indexed by RPI thereafter. This surcharge must have a maximum duration of 20 years from when it falls due and may only apply to existing domestic premises which have not previously received supply of natural gas and have been in existence for not less than 6 months prior to provision of the gas main extended specifically for connection to those premises. This applies where the licensee has, on request, to provide a connection by the owner or occupier of the premises, extended a gas main to specifically connect premises.

5.416. The licensee must notify the Authority of the specified amount and duration as soon as practicable, but in any event no later than 28 days prior to the charge becoming due. The Authority may direct the licensee not to make the surcharge within this 28 day period.

Proposed change

5.417. As set out in relation to Standard Condition 18, Ofgem is aware that the NTS-GT licensee will continue to have permission under the Gas Act to supply all premises even though Transco has advised Ofgem it currently has no domestic premises connected to it. Ofgem therefore considers that this condition should apply to both NTS and DN-GT Licences as a Standard Special Condition.

5.418. It is currently Ofgem's intention to propose these amendments as part of the section 23 notice to be published in November 2004.

5.419. Ofgem welcomes respondents' views on the proposal not to amend this condition.

Schedule A - NTS Output Measures for the Price Control

Description

5.420. Schedule A sets out the output measures for the NTS price control.

Proposed change

5.421. Ofgem recognises that this schedule may require to be revised subject to reform of the interruptions and exit capacity arrangements. The schedule may require to be revised to reflect any changes in cross references.

5.422. It is currently Ofgem's intention to propose these amendments as part of the section 8AA transfer process.

5.423. Ofgem welcomes respondents' views on the proposal to amend this condition.

Schedule 1 – Specified Area

Description

5.424. This describes the Specified Area for Transco which is Great Britain.

Proposed change

- 5.425. This issue is under consideration as part of the licence application consultation process. Ofgem would invite respondents to comment on this issue as part of that process.

Schedule 2 – Revocation of Licence

Description

- 5.426. This schedule describes the circumstances in which the Authority may revoke Transco's GT licence.

Proposed change

- 5.427. Ofgem does not propose to modify this schedule.
- 5.428. Ofgem welcomes respondents' views on its proposal not to modify this schedule.

Schedule 3 – Transportation Services Area

Description

- 5.429. This sets out the transportation services area for Transco which is Great Britain.

Proposed change

- 5.430. This issue is under consideration and Ofgem will, following consideration of respondents' views take a view on whether any modifications are required. Ofgem would invite respondents to make any comments they have on this issue.

6. New licence conditions

6.1. As has been explained elsewhere in this document, if the sale of one or more DNs proceeds, Ofgem considers that it may be appropriate to introduce certain new obligations that are not covered by Transco's existing GT licence in the form required. This Chapter provides a high level outline of a number of possible new NTS and DN-GT licence conditions that could be adopted as a part of the DN sales reforms, including:

- ◆ private collective licence modification procedure;
- ◆ the switch on/off of standard conditions;
- ◆ implementation of gateway requirements;
- ◆ changes to the interruptions arrangements;
- ◆ requirement not to prejudice the systems of other GTs;
- ◆ inter-operator service agreements;
- ◆ governance of technical standards; and
- ◆ arrangements for gas measurement.

6.2. The list of potential new licence conditions described in this Chapter is not exhaustive and is intended as a guide only. New issues are likely to arise as a part of ongoing work to develop more detailed business rules to support a divested industry structure. In this case, the Authority reserves the right to propose additional new licence conditions either in the formal section 23 notice or during the section 8AA process or as part of the consents to the disposal of DN assets.

6.3. Ofgem invites views on the above list and on whether any other new licence conditions should be considered as a part of the DN sales process.

Private CLM procedure

Description of issue

- 6.4. Chapter 3 sets out Ofgem's proposal regarding the introduction of a private CLM procedure, which would be equivalent to the statutory CLM procedure except that it would apply only to the NTS and DN-GT licensees. If introduced, this private CLM procedure would apply to specified Standard Special Conditions in the GT licences of the NTS, the RDN and IDNs where conditions common to a number of licensees appear in the revised licences. The private CLM procedure could be established by the inclusion of new conditions in the licences of the relevant DN and NTS licensees. The effect of the private CLM procedure would be to enable licence modifications to those conditions which are subject to the procedure to be introduced into the licences of all the relevant class of licence holder without the need to obtain individual consent to the modification from each licensee. As explained in Chapter 3, this private CLM procedure will not preclude the ability of Ofgem to seek individual licence modifications with the consent of the relevant licensee.

Proposed treatment

- 6.5. Ofgem invites views on whether the private CLM procedure should be a Standard Special Condition in NTS and DN-GT licences. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.

Switch on/switch off

Description of issue

- 6.6. As discussed in Chapter 3, Ofgem would (where possible) seek to revert the Amended Standard Conditions (and certain Special Conditions) in Transco's existing GT licence and, if granted, the new additional GT licences to the Standard Conditions designated by the Secretary of State, as updated by Ofgem pursuant to the statutory CLM procedure. However, this may not be appropriate in every case and, where a modification is required to a Standard Condition, instead of using an Amended Standard Condition at this time, Ofgem proposes to repeat the relevant Standard Condition (with the necessary amendments) as a

Standard Special Condition which would be subject to the private CLM procedure. This would mean that Transco and the owners of the DNs would be subject to two similar conditions in respect of the same issue. It will therefore be necessary as part of the process for modifying Transco's GT licences, to "switch off" those Standard Conditions that have been replaced by Standard Special Conditions.

- 6.7. Standard Conditions in all GT licences are currently split into 3 sections, section C of the Standard Conditions of the GT licence is already capable of being switched on or switched off under Standard Condition 2. Ofgem would propose, pursuant to section 7(B)(7)(a) of the Gas Act, to introduce a new Special Condition enabling the Authority to also switch on or switch off Standard Conditions in sections A and B, with the consent of the licence holder. As with Standard Condition 2, this switch would be capable of being used in relation to entire conditions or parts of conditions and would not be time limited, enabling it to be used in the future⁵¹.
- 6.8. Ofgem invites views on whether the new switch condition should be introduced as a Standard Special Condition. It is currently Ofgem's intention to propose these modifications as part of the section 23 notice to be published in November 2004.

Implementation of gateway requirements

Description of issue

- 6.9. It may be necessary to develop new licence conditions that oblige NTS and DN-GTs to implement the gateway requirements⁵² associated with the sale process.
- 6.10. For instance, new licence conditions could be necessary in cases where necessary reforms are unable to be completed until after the point when the Authority grants consent to Transco. The detail of the reforms associated with DN sales is currently being developed by the industry through the working groups. At present, Ofgem does not consider that it has sufficient clarity to

⁵¹ Ofgem is satisfied that the introduction of this switch and the use of it in the context of DN sales would not cause any undue discrimination against IGTs (who would not have such a switch in their licences)

⁵² As outlined in the document "National Grid Transco – Potential sale of network distribution businesses, A Consultation Document. Ofgem, July 2003".

specify the potential new conditions, however it is likely that they would relate, without limitation, to the implementation of the Authority's decisions regarding:

- ◆ the allocation of roles and responsibilities between the NTS and DNs;
- ◆ the agency and governance arrangements;
- ◆ the offtake arrangements; and
- ◆ the interruptions arrangements.

6.11. In addition, it might be appropriate to introduce conditions to ensure that there is no undue discrimination between, for instance, IDNs and RDNs.

Proposed treatment

6.12. It is currently Ofgem's intention to propose additional new licence conditions as part of the section 23 notice to be published in November 2004. However, it may be necessary to introduce the necessary changes at a later stage of the process.

6.13. Ofgem invites views on what additional new licence conditions may be required to give effect to the reforms associated with DN sales.

Requirement not to prejudice the system of other GTs

Description of issue

6.14. In order to ensure efficient cooperation, a new condition might be needed to ensure that DN and NTS owners refrain from actions that could prejudice the safe and efficient operation of networks other than their own. This condition could also affect the system and network planning processes. Such a condition might also be needed as a reciprocal requirement for the NTS.

Proposed treatment

6.15. Ofgem invites views on whether a new licence condition obliging licensees not to act in a manner which could prejudice the safe and efficient operation of each other's systems should be introduced. This could be similar to the existing conditions in shippers' licences (e.g. Standard Condition 3 of the Gas Shipper

licence). If so, we consider that this should be a Standard Special Condition on NTS and DN-GTs.

- 6.16. In examining these issues, Ofgem has considered whether it would be appropriate to propose a similar condition on IGTs with respect to the networks to which they are connected. Ofgem considers that this is not an issue that arises through the DN Sales process. Further, Ofgem has considered whether it would be unduly discriminatory to propose such a condition for the NTS and the DN-GTs without proposing a similar condition for IGTs. Ofgem's conclusion is that, it does not. Ofgem does, however, invite views on this point.

Inter-operator service agreements (including SOMSAs)

Description of issue

- 6.17. If one or more DNs are sold, then it is likely that NTS and DN-GTs will enter into a variety of contracts for the provision of services. Examples include:
- ◆ transitional NSAs between the NTS and DNs, including SOMSAs;
 - ◆ contracts to procure the use of the 0800 emergency telephone service; and / or
 - ◆ arrangements for the provision of the First Line Emergency Response services.
- 6.18. As already noted in Chapter 4, the workgroups have considered whether these agreements should be subject to regulation. Furthermore, as also noted in Chapter 4, Ofgem has provided the workgroups with an initial view that SOMSAs should not be regulated.
- 6.19. The workgroups have considered whether other inter-operator agreements should be regulated and whether they should be subject to a new licence condition in order to ensure that services are provided on reasonable terms.

Proposed treatment

- 6.20. In Ofgem's view, when considering whether to regulate inter-operator service agreements relevant factors might include:

- ◆ whether the service is a monopoly service or a contestable service; and/or
- ◆ whether the service is transitional or enduring.

6.21. In light of these potentially relevant factors, Ofgem invites views on whether it is appropriate to introduce a new licence condition (or conditions) to regulate inter-operator service agreements, including SOMSAs and other NSAs. If respondents consider that such agreements should be regulated, they should specify to which services the new licence condition should apply. Following consideration of respondents' views, Ofgem will consider the appropriate form of licence condition that might be required.

Governance of technical standards

Description of issue

- 6.22. It may be appropriate to develop a new licence condition relating to the governance arrangements applying to the technical specifications and operational procedures for making connections to networks. When all networks are owned by a single company, it follows that there is only one standard for any particular activity. Many third party companies, including utility infrastructure providers and meter owners, interface directly with the DNs. If there are multiple DN owners, different technical standards and procedures could be introduced. This could restrict the development of competition and efficient operation in these areas, as third party companies would be required to comply with differing standards depending on with which network they are interfacing.
- 6.23. To reduce the risk of this outcome, common governance arrangements could be adopted covering all specifications, procedures and accreditation schemes imposed by the DNs on third party companies who interface directly with their networks. This approach could involve the establishment of a review panel to manage the governance of standards and procedures, where the review panel includes representatives of network users and consumers as well as DNs. Ofgem introduced arrangements of this nature in the electricity industry in

October 2002, however, the arrangements were documented through industry codes rather than through licence conditions.⁵³

Proposed treatment

- 6.24. Ofgem invites views on whether it is appropriate to introduce a new Standard Special Condition applying to DN-GTs concerning the governance of technical standards. Also, Ofgem invites views on whether respondents consider this issue to be more appropriately dealt with elsewhere in the regulatory framework.

Arrangements for gas measurement

- 6.25. The workgroup process has identified concern among some industry participants regarding certain aspects of the arrangements for gas measurement.

Arrangements for testing measuring equipment at the NTS/DN interface

Description of issue

- 6.26. Equipment installed at the interface between the NTS and DNs measures the volume, energy content and characteristics of gas flows. These parameters have a direct impact on the volume of gas for which customers are charged, and consequently it is important that the measuring equipment is accurate. At present, the testing regime is based partially on a regime established by the Gas (Calculation of Thermal Energy) Regulations 1996. However, the powers granted to Ofgem under the Regulations are not comprehensive and consequently Transco has agreed with Ofgem to undergo regular independent audits.
- 6.27. Going forward, it is possible that this process could break down if IDNs (or indeed Transco) were unwilling to participate in the informal arrangements. One option for addressing this risk would be to introduce a new licence condition to formalise the arrangements. However, Ofgem is concerned that this approach could be overly prescriptive in this instance.

⁵³ *Governance of Electrical Standards, Final Proposals*, Ofgem, October 2002

Proposed approach

- 6.28. Ofgem invites views on whether it is appropriate to introduce a new licence condition that relates to the testing of measuring equipment. In particular, Ofgem invites views on whether respondents consider this issue could be more appropriately dealt with elsewhere in the regulatory framework, for instance in the UNC.

Arrangements for testing for water vapour

Description of issue

- 6.29. Water vapour content has a direct impact on quantity of gas for which consumers are charged, and consequently it is necessary to test for the presence of water vapour in the distribution networks. When water vapour is found in the distribution network, Ofgem issues Determinations under Section 12 of the Gas Act that reduce affected consumers' bills. Ofgem has historically monitored Transco's network at test points agreed with Transco.
- 6.30. Going forward, it is possible that this process could break down if IDNs (or indeed Transco) were unwilling to participate in the informal arrangements. One option for addressing this risk would be to introduce a new licence condition to formalise the arrangements.

Proposed approach

- 6.31. Ofgem invites views on whether it is appropriate to introduce a new licence condition that relates to the testing of measuring equipment. In particular, Ofgem invites views on whether respondents consider this issue would be more appropriately dealt with elsewhere in the regulatory framework.

7. Way forward

- 7.1. As set out in Chapter 1, Ofgem welcomes views on this consultation document, to be received by close of business on 29 September 2004.
- 7.2. While this document provides a high level outline of changes that may be required to Transco's existing GT licence (and, if granted, the 8 new additional GT licences) in the event of the sale of one or more of Transco's DNs, significant further development and consultation is required before such changes could be implemented.
- 7.3. The key steps associated with the licence amendment process are set out in Table 7.1 (next page). The various steps associated with the licence amendment process are described in more detail in two open letters published on Ofgem's website⁵⁴ and Chapter 4 of this document, and the indicative timetable is attached as Appendix 1.

⁵⁴ Ofgem open letters *Timetable for Potential Gas Distribution Network Sales* (16 July 2004) and *Licence Amendment Process* (5 August 2004). These documents are available on the gas distribution network sales page of Ofgem's website.

Table 7.1 Summary of way forward⁵⁵

| | |
|--|---|
| Release of Transco's draft licences | Transco produces detailed licence drafts for the NTS and DNs (including RDNs and IDNs) in a form which reflects the proposed licence structure discussed in this informal consultation document and indicates many of the modifications which Ofgem will propose to introduce under the section 23 notice. These documents will be published on Ofgem's website in order to inform industry debate. |
| Grant of additional GT licences to Transco | Ofgem receives comments regarding Transco's application for new additional GT licences by 24 September. Subject to consideration of consultation responses, the new additional GT licences would then be granted to Transco. It is anticipated that, at this stage, the new licences will largely mirror Transco's existing GT licence. |
| Issue s23 notice | Ofgem issues a notice under section 23 of the Gas Act to formally modify each of Transco's GT licences (i.e. Transco's existing GT licence and, if granted, the new additional DN-GT licences). The notice would be consulted upon for 28 days. The notice will reflect Ofgem's consideration of views expressed in relation to this informal consultation document. |
| Amendment of licences | In the event that the Authority consents to a sale then, subject to consideration of responses, the Authority would issue directions to bring into effect the modifications to Transco's existing GT licence and, if granted, the new additional DN-GT licences. If respondents raise any significant issues, a further section 23 notice may need to be issued. |
| Issue consultation on transfer of licences to wholly owned Transco entities | Transco applies for the new DN-GT licences to be transferred to the DN companies that are wholly owned by Transco and there is a two month formal consultation under section 8AA the Gas Act relating to the transfer. Any issues that remain outstanding following the section 23 process may be addressed as part of the section 8AA process. |
| Transfer of licences | Subject to responses received in the section 8AA consultation process, the amended DN-GT licences are transferred to Transco's wholly owned DN companies. |
| Consent to sale of shares in DN companies to purchasers | It may be necessary to introduce further changes to Transco's existing GT licence and, if granted, the new additional DN-GT licences as part of the Authority's consent to Transco to dispose of the shares in the DN companies to third party purchasers. |

⁵⁵ Shading indicates that the step is subject to the outcome of the Authority decision on whether to consent to the proposed DN sales

Appendix 1: DN Sales project indicative timetable

