Direct line: 020 7752 2199
Fax number: 020 7752 2128

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

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Dear Sonia

Restructuring of Transco plc's Gas Transporter Licences

Thank you for providing EDF Energy with the opportunity to respond to Ofgem's consultation document on the restructuring of gas transporter licences.

General

We have some significant legal concerns about Ofgem's proposed approach to the restructuring of the licences. Those concerns are set out in a separate analysis (attached) which has been prepared by my colleague Roger Barnard.

The following comments deal with a number of policy issues within your paper and do not attempt to address each and every licence condition which is likely to be changed.

Implementation of gateway requirements

We do not believe that it is appropriate to include a new licence condition for the reform of interruption or offtake arrangements. We do not believe that the reform of the NTS exit capacity regime should be a gateway requirement for the gas DN sales project

Transportation charging arrangements

We are concerned at the prospect that distribution charges could be revised more frequently. Ofgem has decided that the Joint Office (Governance Entity) should be responsible for managing modifications to the distribution charging arrangements and that there will be licence obligations requiring reasonable endeavours. However, we note that each transporter has to comply with the appropriate incentives and may have to adjust charges in response to over or under recovery.

Emergency services co-ordination

We welcome discussion on these issues. As to whether technicians employed by one DN-GT should be required to work on another's systems, we have mixed views. It may be fastest for this to happen, but there could also be circumstances where safety risks and complex liability issues could arise where the technician did not have sufficient knowledge of the third party network to complete the task properly. These issues need to be carefully thought through in formulating proposals. It will be appropriate to place a licence obligation on all DN-GTs to continue to provide monopoly emergency services to all IGTs at a reasonable rate. We also agree that it will be appropriate for the DN-GTs to provide first response emergency services to the NTS-GT at a reasonable rate.

System operator managed services agreements (SOMSA)

We believe that it will be appropriate to regulate network service agreements between DNs and the NTS following the sale of the DNs. As gas shippers are paying for these services, we believe that it will be important to ensure that the SOMSA are transparent and regulated for all market participants.

Network Code and offtake arrangements

We believe that the Unified Network Code should include all of the commercial arrangements, including the NTS offtake points. A separate Offtake Code would introduce the kind of cross-governance issues which occur adversely in electricity because of the stand-alone nature of the major industry codes. Also, if there were a separate Offtake Code, it would need to be designated by the Secretary of State for appeal purposes to avoid the incentive for "governance arbitrage" between the codes.

Price controls and incentive arrangements

We support the incorporation of incentives to encourage accurate and efficient investment decisions by DNs.

Pipeline security standards

We agree that DN owners should keep the 1 in 20 obligation.

LNG storage arrangements

We believe that LNG storage arrangements should be part of both the NTS and DN-GT licences.

I hope you will find these comments helpful. If you would like to discuss any of them, please contact either Helen Bray on 020 7752 2518, or me.

Yours sincerely

Denis Linford

Director of Regulation

EDF Energy

Attachment: Legal analysis of Ofgem's proposals

Roger Barnard

We have a number of concerns about Ofgem's proposed legal approach to the licence restructuring. In particular, we think that the robustness of the so-called private CLM procedure must be questionable. The legal foundation for that approach can only be inferred from a tiny footnote on page 20 of the consultation paper. On that basis, however, it seems that Ofgem believes that it is able to introduce such a novel procedure pursuant to section 7B(7)(b) of the Gas Act.

Ofgem appears to consider that this provision will allow it to incorporate licence conditions enabling the Authority to modify gas transporter licences in any way (i.e. to any extent) that it thinks fit, consistent with its statutory duties, without recourse to the statutory procedure laid down. This seems highly doubtful for at least two reasons, one relating to the normal rules of statutory construction for a delegating provision such as section 7B(7)(b), and the other arising from the actual language of the section. We address these points in turn below.

1. A provision in an Act of Parliament which delegates the power to amend statute (either the Act in which it is contained or other statutes) is usually known as a Henry VIII clause. While such clauses are perfectly valid, there is much judicial dislike of them and the courts have consistently held that the powers thus conferred must be narrowly and strictly construed.

Section 7B(7)(b) does not properly constitute a Henry VIII clause, since it confers power to amend a licence rather than a statute. However, it seems clear to us that, by analogy with such a clause, this sub-section should be narrowly and strictly construed. This view is strengthened by the fact that the terms of the Secretary of State's gas licensing scheme require the licences to be read and construed as a statute.

2. Even if there were no requirement for a strict and narrow construction, the provision itself is very tightly drawn. In this regard, it should be distinguished from its predecessor provision in the Electricity Act 1989 (prior to the Utilities Act 2000). That earlier provision, now superseded, allowed for licences to be modified in a manner determined by or under the conditions.

Section 7B(7)(b) is, however, much narrower. In particular, it distinguishes between the circumstances and timing under which a modification may be made (which can be determined by or under the conditions) and the nature of the change (the "manner" of modification), which must be specified in the conditions. The reference to "times" and "circumstances" is fairly self-explanatory, and "so determined" simply means that the licence must spell out these factors or contain a mechanism for doing so. "Manner" is a little more difficult, but, with timing and circumstances already taken care of, the meaning of this must go at least in part to the content of the modification as well as procedure.

> We believe that for something to be modified in a specified manner, the content or the purpose of the modification must be specified, Accordingly, it was intra vires for the Secretary of State to use these powers to make some extensive modifications to the gas licences in late 1996 for the specified purpose of securing that they had the same effect (as closely as may be) where a supplier and shipper were the same person. But we believe that this (by way of example) is as far as it is proper to go – not least because of the clear effort which the draftsman has made to subject "manner" to a tighter constraint than "time" or "circumstances".

Looking at the matter in the round, therefore, it seems likely that section 7B(7)(b) does not allow gas licence conditions to provide for a process of self-modification except where either the modification, or its detailed policy objective, is itself spelt out in the conditions in advance. We believe that this interpretation is supported by the DTI's policy intention when this section was introduced, which was to ensure that the primary statutory arrangements for the variation of gas licences are not materially by-passed. It would also be relevant that the Utilities Act 2000 tightened the analogous provision in the Electricity Act to bring it into line with the gas provision, rather than vice versa.

We wonder, in any event, if the problems that Ofgem faces in restructuring the licences are as great as the document supposes. We believe that for most of the differences between IGTs and DN-GTs, it would be possible to use the switch-on/switch-off approach to cater for the differences within a single set of standard conditions subject to the normal statutory modification procedure. This is, we believe, the approach that Parliament intended to such matters.

Obviously, to achieve this (without a reference to the Competition Commission) would require the IGTs not to object in sufficient numbers to block the section 23 notice. Given that the IGTs are essentially unaffected by the process, it is unlikely that sufficient of them would wish to force a Competition Commission inquiry. But even if they do take this step, we believe that it should be faced, rather than seeking to introduce provisions of doubtful validity.

If Ofgem, nevertheless, remains concerned that the existing legal framework for modifying licences is deficient for restructuring purposes, an alternative way forward might be the use of the Secretary of State's powers under section 41C of the Gas Act (powers to alter activities requiring a licence) to decompose the activity of gas transportation into two new separately licensable activities of gas transmission and gas distribution. Such an approach would almost certainly entail a reference to the Competition Commission at some point – but, here again, it could be argued that this is what Parliament would have intended for a project of this scale and nature.

This analysis is being copied to Liz Baker at the DTI, since the Department may have records and in-house knowledge of section7B(7)(b) of the Gas Act, and also because the Secretary of State may wish to assess the lawfulness of any proposed licence changes relying on section 7B(7)(b) in duly exercising her function of deciding whether to veto such changes.

RB/MVB 29.09.04