

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

Your ref 215/04
Our ref
Name Charles Ruffell
Phone 01793 89 39 83
Fax 01793 89 29 81
E-Mail charles.ruffell@rwenpower.com

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**NATIONAL GRID TRANSCO – POTENTIAL SALE OF GAS DISTRIBUTION NETWORK
BUSINESSES INITIAL THOUGHTS ON RESTRUCTURING TRANSCO PLC'S GAS
TRANSPORTER LICENCES
Consultation Document September 2004 215/04**

Dear Sonia

In general, our comments reflect our concerns with those sections of the proposed Gas Transporter Licences (GTL) that impact us as shippers/suppliers or our relationship with customers. We have addressed Ofgem's consultation questions as well as setting out our views on specific licence conditions where appropriate.

We recognise that the need for many of the proposed structural and other changes arise from the requirement to modify a licence designed for a single integrated business to one applicable to a dis-aggregated market structure. This has introduced considerable complexity both into the licence itself and its associated modification procedures. Although it is helpful to have an early sight of a *possible* GTL structure, we are concerned that many key policy issues have still to be determined. The Authority is yet to make final decisions in areas that will have a direct impact on the final form of the licences and these, together with others that may emerge during the various consultation phases will have to be incorporated into final drafting. Continued delay in finalising areas such as offtake arrangements, credit and governance means that much of the detail will be unavailable until the formal Section 23 notice, due in November, or even later. This may not leave sufficient time for a comprehensive review of the final proposals for what will be a fundamentally changed licence and its interrelationship with the UNC and possibly Offtake Code, which are undergoing parallel development. We note that Ofgem has taken significant time to consider what are complex issues. It is only appropriate that shippers and other affected parties are afforded a comparable opportunity.

RWE npower

Trigonos
Windmill Hill
Business Park
Whitehill Way
Swindon
Wiltshire SN5
6PB

T +44(0)1793/8
9 39 83
F +44(0)1793/8
9 29 81
I
www.rwenpower.com

Registered
office:
RWE Energy plc

Distribution charging arrangements

Ofgem has identified two key shipper concerns, namely an uncoordinated approach to charges and charging methodologies and more frequent changes to charges. We fully support the proposed obligation on adopting a standardised charging methodology, although we would prefer a more robust mechanism rather than relying on an obligation to keep charging methodologies under review to maintain a consistent approach. In assessing proposed changes to charging methodologies Ofgem should factor the impact on shippers into its decision. System developments are already required to manage different charge levels and managing multiple charging structures would create significant additional costs. As drafted, it is not clear how any obligations and incentives related to adjusting charges to mitigate over and under recovery will sit alongside the proposed new obligation for limiting the frequency of changes and it is possible that this could lead to conflicting incentives.

The Joint Office is a relatively new concept and, while we agree that there is a need to co-ordinate code modifications and other consultations, we would like to understand the scope of the proposed Joint Office and how it will be resourced to discharge these obligations on behalf of licensees.

Emergency services

DN boundaries: The priority here is to resolve the problem and make safe and there should be an obligation on DNs to ensure that the incident is dealt with. The arrangements under which the DN owners charge themselves for this service is a commercial matter between them;

First response services to IGTs: The key principle should be that customers connected to IGT networks should have the same level of service as non-IGT connectees, certainly with regards to dispatch and make safe. There should be an obligation to make this monopoly emergency service available, bearing in mind that in the short-term it is unclear that there are alternative service providers for the potentially competitive elements of emergency services i.e. repair following make safe. If realistic alternative providers are to be encouraged, then how the DNs charge for these services needs to be considered;

First response services to NTS: We agree that it is more efficient for DNs to have to provide first-line emergency response to the NTS, with NTS retaining specialists to carry out remedial works. The NTS should enter into a contract for these first-line services.

SOMSA

Our understanding is that the SOMSA is anticipated to run until the end of the current price control period. While the costs of the services provided under the SOMSA are funded under the current price control settlement, we agree that there is no need to regulate this agreement. However, we are less certain what will happen beyond the end of this price control period. It is not clear whether any of the new DN owners will establish system operation control rooms, even though that is clearly the intent of time-limiting the contract. If not, then there is only one realistic service provider and we would not rule out future regulation of the SOMSA in these circumstances. If the IDNs face excessive costs for continuing to procure this unregulated service, then Ofgem should not allow these to feed through to customers at the next price control. Whether control over this agreement is best facilitated via a new Licence Condition that is currently dormant or by adding a new Condition if needed in the future is a drafting question. If it is more efficient for DN owners to meet their system operation obligations by procuring a 3rd party service, then the arrangements should not preclude that option.

Network Code and offtake arrangements

In order to ensure consistency between networks and prevent fragmentation, our preference is for a single UNC. However, if a UNC together with short-form codes for each network is the way forward then there should be corresponding licence obligations to restrict unilateral code modification. We believe that any offtake code should be between the NTS and DNs only and replace the internal Transco code that governs operational arrangements at the NTS/DN interface, as these are operator-to-operator processes. There should be no fundamental changes to current offtake arrangements with NExAs and other contracts retained as bilateral agreements outside the UNC (although referenced to it where appropriate). It is wholly inappropriate for these to be included within the UNC and potentially be subject to change by unaffected parties. In our view, these minimal changes would be sufficient in the context of the DN sale process and we strongly believe that further changes at exit are unwarranted and may jeopardise the sale timetable.

Pipeline security standard

To be consistent with the preferred option 2 the “*DN booking model*” the DN-GT licence should contain a 1-in-20 obligation. Each DN will book NTS exit capacity on the basis of shipper requests and consistent with the 1-in-20 and any capacity investment incentives. It is not clear that the NTS should face a similar licence obligation, as they will be responding to the DNs’ capacity requests (and to the entry capacity incentive on the entry side). The licence should facilitate a regime that encourages efficient and possibly innovative investment by DNs as these will be a principal driver of benefits following any sale. These investments may change the relationship between the DN and NTS in terms of capacity provision. An example of such an investment may be to increase local DN capacity, thereby reducing dependence on the NTS. In the absence of licence obligations for NTS investment it needs to be considered how incentives are applied to ensure ongoing efficient NTS investment.

Treatment of LNG

Providing that shippers using LNG are held whole, the treatment of boil-off gas is an operator-to-operator issue and the obligation could sit in the NTS licence only. However, LNG is likely to increase in importance in the mix of potential UK gas supplies as traditional UKCS sources deplete. There are a number of planned developments for LNG import terminals as well as continued usage as storage facilities. So, taking a wider perspective, the new licence should not constrain future development in LNG. This, may include LNG connected within a DN if this is economic compared to alternatives. On this basis, the obligation should be in both the NTS and DN licences. The licence should not discriminate between LNG storage and entry points except to reflect any intrinsic differences between them.

Competition concerns

For clarity, can you explain Ofgem’s current thinking on the future licencing treatment of the IGTs and IDNs where there is common ownership?

Treatment of metering and meter reading services

We agree that it is appropriate to make the provisions of Special Condition 23 a Standard Licence Condition such that it is applicable to NTS and DN licensees. However, we do not believe that the provisions of this condition are strong enough to ensure that GTs will necessarily comply with the requirements of the RGMA Baseline and/or changes to it. This is of particular

concern as one of the DN purchasers owns a metering business and might be expected therefore to deliver its requirement under Amended Standard Condition 8 using a metering service provider other than TMSL. It is to be hoped that a combination of this condition and the fact that NTS and DN licensees will have an obligation under Standard Condition 14 to comply with the SPAA, will result in any new metering service provider's MAM Manual being compliant with the RGMA Baseline. If this is not the case however, suppliers will be faced with considerable costs to adapt their systems to cope with non-standard metering flows.

Where an IDN purchaser owns a metering business they should be obliged to prepare separate Regulatory Accounts under Amended Standard Condition 30 for both meter reading services and metering provision and be bound by the non-discrimination provision of Special Condition 32. We would also expect the tariff caps applicable under Special Condition 31 to be applied uniformly across the IDNs and RDNs.

Specific Licence Conditions

Amended Standard Condition 25 – Long Term Development Statement: We would expect to see individual DN statements, with a co-ordinated NTS statement based on inputs from the DN's;

Amended Standard Condition 30 – Regulatory Accounts: Each DN should produce these so that the benefits of comparative regulation can be maximised. It would be possible to weaken efficiency incentives if owners of more than one DN were able to publish combined regulatory accounts;

Amended Standard Condition 31 – Supply Point Administration Services: We agree with the proposed treatment of this licence condition. In a potentially fragmented industry, it is vital to maintain obligations on registering and maintaining domestic supply point data.

Other Areas

There are some other areas where it is not clear whether there will be licence conditions or if the obligations will be delivered via another mechanism such as UNC or governance arrangements. We would welcome further clarity on how the following concerns will be addressed:

- Whether DN's will face an ongoing obligation to use a central agent to discharge their UNC and GT licence obligations;
- How the requirement to co-ordinate developments between the UNC and SFC will be enforced; and
- Where the demarcation of responsibility between energy and system capacity management as implied in the conclusions of the Roles and Responsibilities RIA will be contained.

We hope that these views are helpful and would be happy to discuss these matters further.

Yours sincerely

By Email So Unsigned

Charles Ruffell
Economic Regulation