

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

Head Office
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Telephone: 01738 456400

Facsimile: 01738 456415

email:

Our Reference:

Your Reference:

Date: 4 October 2004

Dear Sonia

**NGT Potential Sale of Gas Distribution Network Businesses
Initial Thoughts on Restructuring of Transco plc's Gas Transporter Licences**

We welcome the opportunity to respond to the above document.

In particular, we believe that it has been helpful at this stage to gain a better understanding of how Ofgem intends to structure future gas transportation licences to accommodate the sale of one or more of NGT's Distribution Networks (DNs). Furthermore, the consultation provides a framework for the conclusion to be reached on a number of the key issues that have been discussed within the DISG meetings.

We have set out our response to the detailed issues in the attached Appendix 1.

As a point of principle, we believe it is essential to ensure that the only modifications that are made to Transco's licence are those that are required to directly align regulatory responsibilities with appropriate parties following a sale. That is, this process should not seek to change any existing regulatory policy, other than strictly necessary to deliver the DN sales.

As you will see, in general we support Ofgem's proposal to introduce a new category of special licence condition that would be modified through a separate, collective licence modification process (the private collective modification process). In considering this private collective modification process, we believe that there are two main issues: the number of categories of Standard Special Conditions and the voting threshold for the private collective modification process. We consider each of these in Part I of our more detailed comments attached.

Part II of Appendix 1, provides comments to the key issues that Ofgem has raised along with a number of additional issues that we believe should also be addressed, for example metering. Part III provides detailed comments on Ofgem's proposals for each licence condition.

I hope that you will find these comments useful. If there is anything that you would like to discuss in more detail, please give me a call.

Yours sincerely

Rob McDonald
Director of Regulation

National Grid Transco – Potential Sale of Gas Distribution Network Businesses.

SSE response to Ofgem's Initial Thoughts on Restructuring of Transco plc's Gas Transporter Licences. September 2004.

Part I. Restructuring Transco's GT Licence

1. Number of GT Licences.

As we have indicated through the DISG meetings and in our response to Ofgem's notice of proposed grant of eight new additional gas transporter licences, we support Ofgem's preliminary view that Distribution Network (DN) businesses in the same ownership will not be required to be legally separate entities. We understand, therefore, that the number of licences that will be required by Transco, and ultimately the new DN owners, will depend entirely upon the way in which these DN owners wish to structure themselves. We believe that this is a simple and pragmatic approach to take. Clearly it will be important to ensure that the structure and content of the relevant price control, accounting and reporting licence conditions that will apply to a legal entity owning more than one DN business does not compromise the opportunities and benefits associated with comparative regulation.

As SSE has already stated in a letter to Ofgem, following completion of the acquisition we propose to structure the two DNs we (as part of a consortium) have agreed to purchase from NGT as separate legal entities and will, therefore, require two separate licences.

2. Regulatory Issues Arising from the Changes to GT Licences and Ofgem's proposals

In order to facilitate a sale, we agree that it will be necessary to modify Transco's existing licence, and any new licence granted to it, to accommodate the National Transmission (NTS) business, Transco's RDN business and independently owned DN (IDN) businesses. In particular it will be important to ensure that the DNs are not bound by licence conditions that are related to the function and operation of the NTS business.

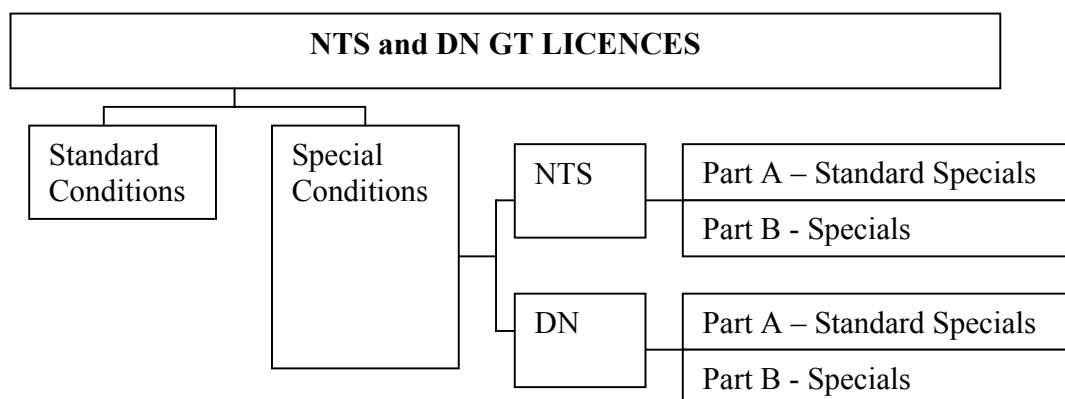
We agree with Ofgem's approach that as far as possible, the DN sales process should only seek to modify those licence conditions that apply to Transco's licence(s). That is, we do not believe that there should be any modifications that seek to alter the established regulatory policies as a part of this process. The modifications should only seek to ensure that precise regulatory obligations are targeted at the appropriate parties following a sale.

In order to achieve this and to maintain as far as possible a uniform regulatory regime that would apply to the existing Transco networks following a sale, we support Ofgem's proposal to introduce a new category of "common" or Standard Special Licence Conditions that would be modified by the proposed private collective licence

modification process. We believe that this approach offers a pragmatic solution to the separation of Transco’s existing licence(s).

However, we do not believe that it is appropriate to have Standard Special Licence Conditions that would apply to both the NTS and DN businesses as a separate category. As a point of principle, we believe that different “classes” of licensee should be subject to and only able to influence specific licence obligations that belong to that “class” of activity. To the extent that there are obligations that are relevant to each class, these obligations should be mirrored and applied to the separate activities.

Therefore, where Ofgem has proposed that a Standard Special Licence Condition is created that applies to both the NTS-GT and the DN-GTs, we firmly believe that a separate Standard Special Licence Condition should be included in Part A of the NTS suite of special licence conditions and an equivalent Standard Special Licence Condition should be included in Part A of the DN suite of Standard Special Licence Conditions. This principle has been established within the electricity licensing regime whereby Transmission and Distribution businesses have many common obligations but that are mirrored in their respective licences. Therefore, we believe that this principle should be preserved in the future gas-licensing regime and the future structure should therefore be as illustrated in the diagram below:



Turning now to the proposed private collective modification process. We firmly believe that Ofgem’s powers to introduce new or amended licence conditions within the proposed new Transco licence(s) should not be enhanced. Furthermore, the existing, statutory collective licence modification process was introduced after extensive consultation and was deemed appropriate in all circumstances to protect the interests of licensees the board. We therefore believe that the proposed private collective modification process should mirror the statutory collective modification process. That is, a 20% threshold should be applied to collective voting, based on the relevant quantities of gas conveyed by the networks AND the number of licenses.

In accordance with our support of Ofgem’s proposals for the introduction of Standard Special Licence Conditions, it would seem appropriate to introduce a mechanism that enables Standard Licence Conditions in sections A and B of the GT licence to be switched on/off as well as those in section C, but only with the Licensee’s consent. We

believe that this would provide a mechanism for Ofgem to move from the existing framework whereby Transco is bound by Amended Standard Licence Conditions to Ofgem's proposed framework of Standard Special Licence Conditions. However, we believe that it will be necessary to ensure that the concurrent application of the Standard Condition and the equivalent Standard Special Licence Condition should only be momentary. That is, we do not believe that it would be appropriate for a licensee to be bound by two "equivalent" conditions for operational purposes and concurrency should, therefore, only be a facilitating measure.

We believe that Ofgem's approach is broadly provided for by the Gas Act pursuant to Section 7B(7)(b). Nevertheless, and assuming that it is possible for this route is to be pursued, it will be necessary to ensure that the drafting of the proposed Standard Special Licence Condition(s) that relate to these arrangements are sufficiently robust to meet the criteria set out in that Section of the Act. It will also be essential to ensure that network owners to whom these arrangements will apply are quite sure of the circumstances and processes associated with these arrangements including when they would be invoked/exercised.

In addition to the Standard Special Licence Conditions, we agree with Ofgem that there will be a requirement for the NTS and the separate DN businesses to have licence-specific Special Conditions, that would, at the very least be associated with the separate price controls. In accordance with existing arrangements, these special conditions would only be introduced and amended by individual licensee's consent. For ease of organisation, it would seem appropriate that these are placed in a separate Part B of the NTS and DN Special Licence Conditions, i.e. in a separate section to the proposed Standard Special Licence Conditions.

3. Mechanics of the Section 23 Notice.

Our understanding of this process is as follows:

- The new Standard Special Licence Conditions that will apply to the NTS and DNs would be proposed and introduced. Some of these will be new, others will in effect be replicating existing Amended Standard Licence Conditions.
- At the same time there would be a modification to remove the amended parts of the existing Amended Standard Licence Conditions thus reverting them to being Standard Licence Conditions.
- Momentarily, therefore, in some instances Transco would be subject to two similar licence conditions, the new Standard Special Licence Condition and the Standard Licence Condition.
- Ofgem then switch off those Standard Conditions in Sections A, B and C of the licence that are replicated and modified by the Standard Special Licence Conditions. This is facilitated by Standard Condition 2 (in respect of Section C) and a new Standard Special Licence Condition (in respect of Sections A and B).

Should this understanding be incorrect, we would welcome further clarity on the proposed mechanics of the Section 23 notice.

We understand that Ofgem proposes to make the majority of the changes to Transco's licence(s) through the Section 23 modification process. We agree that it would be helpful to address as many of the proposed modifications to Transco's licence(s) as possible through the Section 23 process in order to provide regulatory clarity as soon as possible.

Part II. Key Issues

We believe that there are a number of additional issues that need to be considered as a part of the licence modification process in addition to those that have been identified by Ofgem in this consultation document. We have therefore included these and our specific concerns in this section of our response.

1. Transportation charging arrangements

We understand the concerns that have been expressed in respect of the potential for divergence of DN charging methodologies, the frequency and timing of such changes and the frequency and timing of changes to transportation charges themselves. Stability in transportation charging going forward is important for retail competition. However, we are also mindful that there is a risk of being over prescriptive in the governance of transportation charging arrangements and believe that any requirement to amend charging methodologies simultaneously or make them consistent may stifle any such innovation generated by comparative regulation.

As a compromise therefore, we support Ofgem's proposals that would place the responsibility of managing the transportation charging arrangements modification process with the Joint Office (JO). For the avoidance of doubt however, it should be quite clear that the ultimate decision of whether to propose an amendment to the methodology following the requisite consultation process etc should lie entirely with the network owner. Therefore the ultimate "control" of the potential divergence of transportation charging arrangements would lie with Ofgem through their right to veto.

Similarly, we support Ofgem's proposals to introduce a reasonable endeavours obligation on the NTS and DNs to only change their charges once a year, on a specified date. We agree that this obligation would, in effect, be "subordinate" to the best endeavours obligation and incentive arrangements to ensure that transportation revenues do not exceed maximum allowed revenues provided for in respective price controls. That is, we understand that this would mean that, in the event that a licensee changed its transportation charges more than once a year in order to comply with its over/under recovery restrictions, it would not be in breach of its reasonable endeavours obligation. Ofgem has suggested that the possible specified date could be 1 October. However, we believe that it may be preferable to consider a 1 April date since this would be aligned with the accounting and price control financial year.

2. Emergency Services Co-ordination

- a) **IGT issues.** We support the view that DNs should have a licence obligation to provide emergency response services to iGTs located within their networks. We also believe that DNs should be able to recover reasonable costs for the provision of this service. In addition, we believe that it would be appropriate for the DNs to have an obligation to provide a repair service of last "last resort" on commercial terms that allowed it to recover a reasonable profit for the provision of this service.

- b) **DN boundary issues.** We also support the proposal to ensure that which ever DN is notified of an incident it would be obliged to despatch an engineer to make safe the incident regardless of the network on which it transpires that the incident has actually occurred on. As this would be a reciprocal arrangement, we initially believe that the provision associated with this obligation would be included as part of the DN's operational expenditure and would not, therefore, be subject to a commercial contract. However, we believe that some sort of monitoring should apply to the incidence of "incorrect" call outs since it would be clearly unacceptable if one DN were continuously being called to incidents on a neighbouring network. For the avoidance of doubt, this obligation should not include any associated repairs, it should purely be a respond and make safe requirement.
- c) **NTS First Response.** We believe that Ofgem's RIA on the roles and responsibilities of the NTS and DN licensees has established, beyond doubt, that the obligations associated with a network should lie with that network even if they are discharged through a commercial contract. On this basis we have, to date, supported the application of this principle to the issue of NTS first response emergency services. However, we understand the logic for this licence condition and in particular why it might be more efficient for the DN to provide this service for the NTS. To the extent that there are any price control issues, we believe that it would be possible to deal with this as an interim solution and provide a permanent "fix" at the time of the next price control review.
- d) **Liability issues.** In each of the three scenarios above, there are potential liability issues associated with a licensee dealing with incidents, or making repairs, on a network belonging to another. However, in the event that these services are to be provided for through licence obligations, we firmly believe that any liability associated with a "failure" by the Licensee providing the service should be limited to the penalties that are associated with a breach of licence. That is, there should be no other consequential or supplementary liabilities associated with any such "failure" for the service providing licensee.

3. System Operator Managed Services Agreements and other NSAs

There have been a number of discussions within the RIAs and within DISG about whether the SOMSA and other NSAs should be regulated. We believe that these issues have now been resolved.

4. Network Code and Offtake Arrangements

We are somewhat concerned that the Offtake arrangements that will apply following a DN sale have yet to be determined. Nevertheless, to date we have supported NGT's approach whereby the provisions of the UNC and those of the Offtake arrangements would be in separate agreements. We believe that this would be the simplest approach due to the number of NTS/DN interface issues that will have no shipper involvement.

However, we are unsure what is meant by “a single set of overarching governance arrangements that would apply to both agreements”. This is because signatories to the UNC will be shippers whereas it is expected that signatories to the Offtake code will be other network owners (ie RDNs and the IDNs) and potentially NTS directly connected customers. Therefore, we do not believe that it would be possible for uniform governance arrangements to be developed that would apply to both, although it is likely that there will be common elements. Only once the relevant signatories of the Offtake code have been identified will it be possible to determine the final change control process that will apply. However, at this stage, we do agree that it seems appropriate for the JO to manage the modifications process for both the UNC and the Offtake Code.

5. Price Control and Incentive Arrangements

As Ofgem has identified, although there is no intention to reopen Transco’s price control, a key element of the modifications that will need to be made to Transco’s licence will be to ensure that the price control provisions are appropriately reflected in the separate DN licences. Where appropriate, it will also be necessary to ensure that the new NTS/DN interface/commercial arrangements (ie UNC and/or Offtake code) adequately address any NTS/DN interactions associated with the price controls including Transco’s NTS SO incentive scheme.

We very much welcome Ofgem’s early indication that any new, DN incentive scheme that would apply to the new offtake arrangements would, initially, have a duration of one year only. Furthermore we agree that any such scheme should be introduced as a supplementary, new special condition separate to the existing price control. Ofgem has indicated that it intends to consider these issues in a forthcoming consultation document scheduled for November. When considering the potential scope and form of any potential incentive scheme in this respect, we would urge Ofgem to keep it as simple as possible, in the interests of meeting the overall project timetable.

In the event that the offtake arrangements provide for direct financial flows between the NTS and DNs for the provision of primary NTS exit capacity at the NTS/DN interface, subject to any incentive payment, an additional DN revenue allowance will be required that is recoverable through DN transportation charges. Again, as above, we believe that this could be provided for by an additional, supplementary price control special licence condition.

We note that a considerable amount of uncertainty surrounds the NTS Offtake arrangements and any associated price control and/or new DN incentive schemes. Furthermore, it is evident that a substantial amount of work will be required in order to resolve these issues before any work on drafting the specific licence conditions will be possible. In light of this, we would urge Ofgem to seek to implement arrangements that are as simple as possible in these respects.

Ofgem’s policy on the “safety net” and NGT’s subsequent acceptance of it quite clearly has no cost implication for the new potential DN owners. We therefore believe that this

is a matter to be agreed between NGT and Ofgem as part of the disposal of assets process.

Finally, as a point of principle, it is important to ensure that any licence condition that is associated with any aspect of a network owner's price control arrangement is maintained as a Special Licence Condition applicable only to that licensee. That is, all price control licence conditions, including any metering cap provisions, should be set out within Ofgem's proposed part B of the NTS and DN special licence conditions.

6. Pipeline Security Standards

Following the sale of one or more DNs and in line with Ofgem's views, we believe that in principle it would be appropriate for the 1 in 20 obligation to apply to both the NTS and DN.

However, under Ofgem's proposed arrangements we are concerned that for a DN to fulfil this obligation, it will be required to procure NTS exit capacity through an auction allocation process. That is, we are concerned that a DN's ability to fulfil its obligation will depend upon on the allocation of that capacity by the NTS. This may not be such an issue in the longer term under Ofgem's proposals since capacity for [three plus] years ahead would be made available on an unconstrained basis. However, in the short term we are concerned that the DN would have to compete with commercial NTS direct connects (such as large CCGTs) in order to meet their 1 in 20 obligation. This could result in considerable "additional" cost for the DNs, which, unless provided for through transportation allowed revenue, would be unacceptable.

We therefore believe that greater consideration must be given to this issue as part of the Offtake arrangements and the associated DN supplementary price control and incentive arrangements referred to above.

7. Metering

We understand from DISG discussions that Ofgem intends to consider metering issues at a future DISG meeting and we look forward to participating in that debate at that time.

Nevertheless, we note that Ofgem's view at this stage is that the provisions of existing Amended Standard Licence Condition 8 (which essentially provides for the network owner to be a meter provider of last resort) would be replicated through a Standard Special Licence Condition and applied to both the NTS and the DN licences. As explained below, we do not support this proposal.

The regulated metering assets associated with the provision of the metering obligation have not been included as part of the DN sales process. We therefore do not believe that it is appropriate for the metering obligation to be transferred to the new DN owners without the associated assets to fulfil an obligation of last resort. Ofgem has recognised that the IDN will not have the metering assets and therefore, its intention is to enable

DN's (in particular IDNs) to fulfil the obligation via a third party contract. However, we do not believe that this is sufficient.

The introduction of RGMA and competition in gas metering means that the extent to which the IDN will be required to provide a meter will be unknown. Therefore, the IDN will be required to enter into a commercial contract for the delivery of a service that might be required to provide one, or maybe thousands of gas meters. A contract of this nature is likely, in our view, to be far more expensive than the costs that Transco will incur in providing that service through the use of its regulated metering asset base. Furthermore, it is more than likely that the IDN will have to contract with Transco metering services to provide and maintain that meter (since Transco's policy is only to provide an aggregated meter provision and maintenance service).

Therefore, we firmly believe that the metering obligation should be retained by Transco as a special licence condition that should continue to apply GB-wide and not only to its RDNs.

In the event that all DN's are required to provide a metering service of last resort, it is not appropriate to simply replicate Transco's existing metering price control Special Licence Condition as a Standard Special Licence Condition that will apply equally to the RDNs and each of the IDNs. Any price control licence condition should be network specific and therefore provided for within separate Special Licence Conditions. Furthermore, as we have indicated above, the IDN would be providing this service under very different circumstances to the RDNs (ie without having the associated assets). We therefore believe that it is inappropriate to assume that the relative costs will be the same.

Furthermore, we believe that Transco's metering caps should apply to whomever Transco provides a metering service to. This would mean that in the event that the metering obligation is common to all DN's and, as we expect, the IDN has, in effect, to procure the service for fulfilling its obligation from Transco, Transco's metering caps should apply. We do not believe that the sale of one or more DN's should be used by Transco as a vehicle for Transco to extract metering revenue in excess of the metering caps.

8. LNG

One of the issues that Ofgem has identified in chapter 5 of the consultation, is where to assign the LNG storage licence obligation – to the NTS or to the RDNs. We are aware that there is a potential NTS/DN/LNG Storage interface issue associated with LNG “boil off” that will need to be fully understood and if necessary addressed by the relevant network owners through the proposed Offtake code. However, on balance, we support Transco's view that the most appropriate location for the LNG Storage related licence obligations should be Transco's NTS-GT licence. All references to LNG, therefore, would be removed from conditions in the DN licences.

Consistent with the view that we do not support the creation of a category of Special Standard Licence Conditions that would apply to both the NTS and DN's, we believe that the relevant Special Standard Licence Conditions that apply to the NTS should include

the LNG provisions. This would therefore avoid the requirement to create a number of NTS Special Licence Conditions to augment the relevant Standard Special Licence Conditions in respect of Transco's LNG storage arrangements.

9. Business Separation

Ofgem has also asked for views on potential business separation requirements where a potential purchaser, such as SSE, has other relevant interests. Clearly, this is an issue that is readily understood within the electricity sector and we would agree with Ofgem that it would be appropriate to model any separation requirements that may exist on that framework.

In essence, we believe that there are two key business separation rules that need to be established. The first is that information relating to the Transportation business is confidential. The second is that the Transportation business must not restrict, distort or prevent competition. In other words, we do not believe that the requirements to establish these two fundamental rules need be any more prescriptive than those that have evolved within the electricity industry. Furthermore, we do not believe that these principles vary between DNs that have an affiliation with another relevant business and those that do not. Therefore, in our view, future business separation provisions should be equally relevant to all DNs and NTS alike and therefore should be part of Ofgem's proposed SSC.

Part III. Comments on proposals for Transco's Existing Standard, Amended and Special Licence Conditions

In responding to Ofgem's proposals for the modifications that would apply to Transco's existing Standard and Amended Standard Licence Conditions, we have not commented on those where we are in full agreement of Ofgem.

(Abbreviations used: SLC – Standard Licence Condition; ASC – Amended Standard Condition; SSC – Standard Special Condition; SC – Special Condition).

Standard Conditions

ASC 4 - Charging Gas Shippers – General

- We support the introduction of a reasonable endeavours obligation in respect of frequency of change. However, as Ofgem has indicated, this would not prevent a change to charges more than once a year in the event that there was an over/under recovery of revenue under ASC 28. Furthermore, we believe there may be merit in considering an appropriate date for a single change could be 1st April rather than 1 October.
- We also support the proposal that the co-ordination of the charging methodology change control process should be carried out by the JO. However, we believe that it may be more appropriate for this JO obligation to be contained within ASC4A.
- We support the view that LNG Storage provisions should be contained within the NTS business.
- We support the introduction of SSCs to contain the provisions of this ASC. However, we believe that the SSCs should be contained within parts A of each of the NTS and DN licences. This would also allow the NTS SSC to contain the relevant references to LNG Storage thus avoiding the creation of SCs in this respect. This would also mean that the NTS and DN SSC would be subject to separate private CLM procedures - one in relation to the NTS and the other the DNs.

ASC 4A – Obligations as Regards Charging Methodology

- We are unsure why Ofgem has repeated the reasonable frequency of change endeavours requirement in this condition since it has been covered under ASC 4 above.
- We believe that the role of the JO in the management and co-ordination of modifications to the charging methodology should be contained in this condition rather than ASC 4.
- For the reasons set out in the consultation paper, we agree that it may be appropriate for there to be an obligation on network owners to keep their charging methodologies under review. However, we believe that this obligation should be framed in terms of review “from time to time, but no less than annually”. This would be frequent enough to ensure consistency of approach but without involving constant consultation and review which would create uncertainty and cost for the industry.
- As per ASC 4, we support LNG Storage provisions being retained by the NTS.

- As per ASC 4, we support the introduction of separate SSCs to the NTS and DN licenses to contain the provisions of this ASC. This would also allow the NTS SSC to contain the relevant references to LNG Storage thus avoiding the creation of SCs in this respect. This would also mean that the NTS and DN SSC 4 would be subject to separate private CLM procedures - one in relation to the NTS and the other the DNs.

SLC 4C – Charging of Gas Shippers – Supplemental Connections Charges.

- Given that this condition is time expired we believe that it should be removed from the licence. However, we agree with Ofgem that this should be addressed separately via the statutory CLM process at a later date and not as part of the DN sales process.

ASC 4E – Requirement to Enter into Transportation Arrangements in Conformity with the Network Code

- We support the creation of a separate UNC and Offtake code.
- We agree that it would be appropriate for there to be a requirement for the NTS and DNs to accede to and comply with any offtake arrangements. It would also seem appropriate to place an obligation on the NTS licensee to establish an Offtake Code.
- As per ASC 4, we support the creation of separate SSCs that would apply in to the NTS and the DNs, the NTS version of which would contain references to LNG Storage. This approach would also enable the NTS-specific requirement to create an Offtake code to be provided by that condition.

ASC 6 - Emergency Services and Enquiry Service Obligations

- As we have indicated, we support the proposal to introduce licence obligations in respect of the provision of emergency response to IGTs on a reasonable costs basis, with a further “repair service of last resort” obligation for reasonable profit.
- We agree that there should be an obligation to respond to call outs where there are boundary issues or a call out is made in error.
- We agree that the DN would provide an NTS emergency response service.
- We believe that a Licensee’s liability exposure associated to providing these services should be limited to those associated with a breach of licence.

ASC 8 – Provision and Return of Meters

- As we have discussed in Part II of this response, we do not believe that it is appropriate for the “metering obligation of last resort” to apply equally to RDNs and IDNs. Therefore we do not agree with Ofgem that this condition should become a SSC that would apply to all DNs. Rather, it should be a SC that applies to Transco in respect of all of the DNs.

ASC 9 – Network Code

- We support Transco’s proposals that there will be a requirement to establish a UNC that will contain all of the rules associated with the commercial arrangements. In addition to the UNC, each network will create a short form code (SFC) that would form the direct contractual relationship between the shipper and network owner and which would bind parties to the UNC.

- While we agree that each licensee will have obligations to jointly establishment both the Agency arrangements and the JO, we believe that for clarity, these requirements would sit more comfortably within a separate, new condition rather than being contained within this licence condition. We believe that it would be important that this proposed new condition would also identify the scope of those agency arrangements.
- We do not object to the proposal to introduce a new relevant objective equivalent to that associated with the BSC to ensure the co-ordinated and efficient operation of the NTS and the DN's which would include efficiency in the administration of arrangements.
- We support the view that the UNC modification rules should continue to be set out in the UNC going forward.
- We continue to believe that the modifications to the UNC should be directed by the Authority and that these directions would be subject to a party's right to appeal introduced by the recent Energy Bill. Any discussion on whether it is/is not appropriate for the Authority to approve/direct the implementation of modifications is outside the scope of this project.
- As discussed in Part II of this response, we support the introduction of an Offtake code to govern the NTS/DN offtake arrangements the provision for which would be provided for within the licence.
- We agree that a SSC should be implemented in to Part A of each of the NTS and the DN licences to provide for the provisions of this condition and that the NTS SSC would reference the LNG obligations.

SLC 16 – Pipeline System Security Standards.

- As discussed in Part II of this response, at present we believe that it would be appropriate for this to remain as a SLC. However, it will be necessary to ensure that the future offtake arrangements do not jeopardise, in any way, either the NTS or a DN's ability to meet this obligation.

ASC 17 – Provision of Services for Persons who are of Pensionable Age or Disabled or Chronically Sick: Arrangements in respect of Meters.

- In accordance with our view that the metering obligation of “last resort” should be provided by Transco across all networks, we believe that this condition should only apply to Transco as a part of that obligation.

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

- To avoid non-compliance on day one, we agree that the condition should be amended to remove the time redundant wording in the condition to replace it with a new date, together with wording providing for the date to be varied (ie a specific date or the date on which the licence is granted, whichever is the later).
- We believe that Ofgem's approach to achieve this by creating a SSC rather than amending the SLC is one way of achieving this, however we believe that this could be one instance where it would be relevant to retain the SLC and make the change to that through the statutory CLM process.

SLC 21 – Complaint Handling Procedure

- As per comments against SLC 18 above.

ASC 24 – Provision of Information to the Authority

- As indicated above, we believe the NTS business should include LNG storage. Furthermore, we believe that only the Transco DN businesses should have a reference to metering as we believe that they should have the metering obligation of last resort across all DNs since they have not sold the regulated metering assets associated with the IDNs.

ASC 25 – Long Term Development Statement

- We support Transco's view that a single, co-ordinated, long term development statement covering the whole of Great Britain should be developed by the NTS. The co-ordination requirements for which would be set out in the proposed Offtake Code. We therefore believe that the proposed SSC that would apply to the NTS would include the requirement to produce this statement and the need for it to be co-ordinated between all of the NTS and DNs. The SSC that would apply to the DNs would similarly refer to the need to co-ordinate with the NTS for the preparation of the "joint" statement.

ASC 30 – Regulatory Accounts

- We agree with Ofgem that it will be important that this condition ensures that information is provided separately in relation to each individual DN where a single licensee conducts more than one DN business.
- Clearly, the proposed SSCs that will apply to the NTS and DNs in this respect will need to reflect the outcome of which businesses are relevant for each licensee.

ASC 32 – Interpretation of Section C

- Any modifications to this section in relation to "permitted purpose" will depend upon the outcome of discussions on metering and LNG Storage.

SLC 33 – Designated Registrar of Pipes

- We agree with Ofgem that no changes are required in respect of this licence condition.
- Furthermore, we do not support the view that has been expressed to Ofgem that this condition should become operative. We are confident that future arrangements will ensure that the NTS and DNs each implement robust arrangements in respect of updating, maintaining and where appropriate sharing accurate records of its pipeline systems.

ASC 39 – Restriction on Use of Certain Information and Independence of the Transportation Business

- Generally, we agree that the provisions of this condition would apply to both the NTS and the DNs. This would be consistent with arrangements in the electricity sector. We believe that this would best be achieved by creating SSC in both the NTS and DN

licences that appropriately reflect the activities that are associated with the Transportation Business.

- Ofgem has asked that further consideration be given to whether, in addition to legal separation, further requirements are needed to support the structural separation of the NTS from the RDNs. We believe that essentially there are only two key issues that need to be addressed between the NTS and the RDNs. That is, non-discrimination and appropriate regulatory accounting. We generally believe that adequate provision will be possible through the application of robust non-discrimination licence conditions. This could be achieved through a NTS SC that would apply to the NTS. Therefore, we do not necessarily believe that onerous structural separation and rigorous compliance regimes are necessary in the first instance.
- Ofgem has also asked for views on potential business separation requirements where a potential purchaser, such as SSE, has other relevant interests. Clearly, this is an issue that is readily understood within the electricity sector and we would agree with Ofgem that it would be appropriate to model any separation requirements that may exist on that framework.

In essence, we believe that there are two key business separation rules that need to be established. The first is that information relating to the Transportation business is confidential. The second is that the Transportation business must not restrict, distort or prevent competition. In other words, we do not believe that the requirements to establish these two fundamental rules need be any more prescriptive than those that have evolved within the electricity industry. Furthermore, we do not believe that these principles vary between DNs that have an affiliation with another relevant business and those that do not. Therefore, in our view, future business separation provisions should be equally relevant to all DNs and NTS alike and therefore should be part of Ofgem's proposed SSC.

Special Conditions

SC 4 – Investment Grade Credit Rating

- We agree with Ofgem's proposal to remove this SC and instead revert SLC 46 (Credit Rating of Licensee)
- We believe that it is appropriate to consider the inclusion of other rating agencies. Further thought will be required to ensure that any additional agency is adequately recognised by financial institutions and the industry. Nevertheless, we believe that this is outwith the scope of the project and should therefore be pursued separately.

SC 18 – Conveyance to Independent Systems

- We note that Ofgem intends to consult on the provisions of this licence condition separately and we look forward to participating in the discussion at that time.

SC 19 – Emergency Services to or on Behalf of Other Gas Transporters

- We agree that with the proposal that this condition would apply to the NTS and all DNs and therefore would become a SSC.

- We do not believe that this condition should be expanded to cover emergency services between gas transporters other than when a major loss of supply has occurred. We believe that any addition provisions in this respect should be dealt with separately.

SC 23 – Provision of Meter and Meter Reading Services

- In accordance with our view that the metering obligation should not apply to the IDNs, we believe that the obligations associated with this condition should be retained by Transco only but that they would apply to a GB-wide geographical area.
- We also understand that Transco has received a “derogation” from the requirement to publish a schedule of charges in respect of its meter reading activities. If this is correct, and in the event that IDNs are to be bound by this condition, it would be appropriate that they too are subject to the same.

SC 26 Prohibited Procurement Activities

- While we agree that it would appear necessary that this condition should apply to all networks for network constraint management activities. However, as Ofgem has indicated, its application to the NTS will in addition include system balancing activities. Consistent with our view that we do not support the creation of a category of NTS/DN-SSCs, we believe that the NTS-SSC would include both constraint and system balancing provisions whereas the DN-SSC would only include network constraint provisions.

SC 28B – Restriction on Revenue in Respect of the NTS TO Activity, DO Activity and NTS SO Activity

- Clearly it will be necessary to ensure that this licence condition is appropriately redrafted for each network. In particular, we believe that it will be necessary to ensure that the NTS SO incentive scheme does not contain provisions that relate to the DN. We believe that shrinkage is an issue that will need to be clarified.
- We note that Ofgem intends to introduce a new incentive scheme that would apply to DNs following the outcome of the Offtake arrangements. We believe that this is essential to ensure that the form and scope of this scheme is developed as soon as possible in order to enable network owners to fully understand the regulatory risk. In particular, we believe that it would be possible to introduce a very simple incentive based, for example, on a simple +/-% of allowed revenue along the lines of the existing electricity IIP incentive.

SC 31 – Restriction of Prices in Respect of Tariff Capped Metering Activities

- We do not believe that it is appropriate to introduce a SSC in relation to this condition. In effect, this is a price control arrangement and therefore should be set out in a DN-specific Special Condition. As we have indicated, we do not believe that the IDNs should have a regulated metering obligation and therefore we do not believe that this condition should apply to them. However, in the event that it does, it will be necessary to review any metering cap that relates to each specific IDN.

SC 32 – Non-discrimination in the Provision of Metering Activities

- As per our previous comments on the metering obligations.

SC 34 – Licensee’s Methodology for Determining Incremental Entry Capacity Volumes

- We agree that this provision only relates to the NTS.
- We also believe that there is a requirement to understand more fully the impact of the DN connected entry points and how the NTS will interact with the relevant DN. This has an implication for the existing price controls and NTS incentive scheme that will, at least, need to be considered at the time of the next price control. However, in the meantime, we are hopeful that a satisfactory interim solution will be found, perhaps through specific provisions within the Offtake Code, that would not expose the DN to any regulatory or financial risk.

SC 39 – Charging of Gas Shippers – Domestic Infill Premises

- Since this relates to charging and, therefore, potentially a network owner’s revenue we question whether this would be best suited to be network specific SC rather than a SSC.

Part IV – Potential New Licence Conditions

Private CML Procedure

To the extent that NGT's existing licence is to be redrafted in line with Ofgem's proposals and the introduction of SSCs etc is to be progressed, we believe that it would be necessary to introduce a new SSC in to Part A of both the NTS and DN special conditions to provide for the private CML procedure as one of these new SSCs.

Switch On/Switch Off

As above, in the event that SSCs are to be adopted rather than a suite of individual network specific ASCs there will be a need to have a Switch On/Switch Off mechanism that would apply to SLC in sections A and B of the licence. It would seem appropriate that this facility would be common to all the NTS and DN owners and therefore be introduced as a SSC in to Part A of both the NTS and DN special conditions. However, it is vital that this new condition provides for the consent of the licensee to any individual licence condition being switched on/off.

Implementation of Gateway Requirements

We agree that it may be necessary to develop new licence conditions in relation to the implementation of gateway issues. In particular, we believe that this may be of relevance to the development and implementation of Ofgem's proposals for NTS exit arrangements. Currently, considerable uncertainty surrounds these future arrangements and therefore, we are aware that to implement a full, working solution for the beginning of the next financial year will be extremely challenging. We therefore believe that, rather than risking the implementation of a sub-optimal solution, a pragmatic solution would be to introduce new licence condition(s) to reflect any necessary reforms that are unable to be completed until after the point when the Authority grants consent to Transco.

Requirement not to Prejudice the System of Other GTs

While we understand the rationale behind this proposal, we question whether it is necessary to introduce it as a specific new licence obligation. Instead, we believe that it may be preferable to address this issue as part of the Offtake Code, or UNC licence obligation.

Irrespective of whether or not specific licence conditions are introduced in this respect, it will be necessary to ensure that throughout all of the new framework and commercial agreements that liability issues associated within interconnecting networks are appropriate and unambiguous.

Inter-operator Service Agreements (including SOMSA)

We note Ofgem's view that this agreement should not be regulated.

Governance of Technical Standards

We do not believe that it would be appropriate to introduce a new licence condition relating to the governance arrangements applying to the technical specifications and operational procedures for making connections to networks. We believe this would be unnecessarily onerous and could stifle development. We note that the main rationale for

this provision is that divergence in this respect could restrict the development of competition. In our view, this concern is not justified since all networks will be bound by the provisions of the Competition Act which prevents the abuse of a dominant position. Furthermore, as we have indicated above, we believe that part of the business separation provisions would introduce an obligation on each network owner not to restrict, prevent or distort competition. Finally, to the extent that some form of co-ordination is required we believe that it would be more appropriate to follow the example that has been set in the electricity industry whereby such provisions are provided for through industry codes – rather than through licence conditions.

Arrangements for Gas Measurement

We agree with Ofgem that it would be overly prescriptive to introduce a licence condition to formalise the informal arrangements that Transco and Ofgem have depended upon in respect of arrangements for testing measuring equipment at the NTS/DN interface. To the extent that this is believed to be an issue, in our view, this would be best dealt with through the proposed Offtake Code.

Similarly, we believe that procedures within the Offtake Code or potentially the UNC could be made.

In general, it could also be argued that failure by a network owner to co-operate with either of these issues could be construed as not complying with its duty to operate an efficient network. We therefore do not support the creation of additional licence obligations to cater for these aspects of the arrangements.

Additional Potential New Conditions That Have Been Identified By NGT

In addition to the potential new licence conditions identified by Ofgem in the consultation paper and discussed above, NGT has suggested the following potential new conditions:

- SSC requiring licensees to establish transportation arrangements in accordance with the relevant objectives and prepare a UNC, shortform and Offtake Code. As we have indicated in our responses to the associated existing licence conditions in Part III above, we believe that each network owner would be required to prepare a UNC and Shortform Code. In the event that the Offtake Code provides for the contractual connection arrangements between the NTS and NTS direct connects and DN, the obligation to prepare an Offtake Code might more appropriately lie with the NTS, with all networks having an obligation to be a signatory to and comply with that code. However, in the event that the Offtake Code relates solely to the NTS and DN interface arrangements, we believe that there should be a joint obligation on both the NTS and DN to prepare and be a signatory to the Code.
- SSC for NTS setting out the obligations relating to the revised exit regime. The only way we see that this would be required would be if it were not possible to implement Ofgem's revised exit regime within the current disposal timetable – ie as a gateway issue. In this respect, we believe that the proposal by NGT of this condition is useful and a pragmatic way to proceed.

- SSC dealing with the obligations relating to the JO and the Agency. As we have indicated in Part III above, we believe that there is a requirement to have a licence obligation on both the NTS and the DNs that relates to establishing both the JO and the Agency arrangements.