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to customers*

Shippers, Transco, potential DN purchasers and other interested parties

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15 October 2004

Dear Colleague,

Updated timetable for Potential Gas Distribution Network Sales Project

In July 2004¹ Ofgem issued an open letter (July letter) setting out the indicative regulatory timetable for Transco's proposed sale of one or more of its gas distribution networks (DNs) so that industry participants could plan their resources effectively.

In its July letter Ofgem made it clear that there could be no expectation on the part of Shippers, Transco, potential DN purchasers or any other interested parties either as to what the Authority's final decision in relation to the proposed DN sales may be, or as to the regulatory framework which may be implemented if the Authority consents to the proposal. The information and guidance in the July letter and attachment was provided on an informal basis and should not be treated as binding on the Authority. Nothing in the July letter or the attachment was to be construed as granting any rights or imposing any obligations on the Authority. The July letter also set out that the Authority's discretion in this matter would not be fettered by any statements made in the letter or the attachment.

Ofgem additionally set out that whilst the indicative timetable was challenging, it was feasible, but subject to the following risks:

- ◆ Significant policy or legal issues, which Ofgem was not aware of at that time manifesting themselves which, in Ofgem's opinion, required resolution before the project can proceed. This included the risk of significant unforeseen issues arising from responses to the consultations which Ofgem is required to undertake. Given that this project represents the biggest change to the gas industry for a number of years, we considered the risk of new policy and legal issues arising to be high; and
- ◆ Ofgem would need to reconsider the allocation of roles and responsibilities between the NTS and the DNs in the event that we were unable to develop satisfactory commercial

¹ Timetable for Potential Gas Distribution Network Sales Project. 16 July 2004.

arrangements at the NTS/DN interface that provide for efficient investment, efficient operation and security of supply.

The above risks were not intended to be exhaustive and it was stated that it was possible that the indicative timetable may slip due to other unforeseen eventualities.

An issue has arisen which has implications for the overall timetable. The purpose of this letter is to set out the issue and explain the consequences on the indicative regulatory timetable. Again in issuing this letter there can be no expectation on the part of Shippers, Transco, potential DN purchasers or any other interested parties either as to what the Authority's or the Secretary of State's final decision in relation to the proposed DN sales may be, or as to the regulatory framework which may be implemented if the Authority and / or Secretary of State consents to the proposal. The information and guidance in this letter and attachment is provided on an informal basis and should not be treated as binding on the Authority or Secretary of State. Nothing in this letter or the attachment is to be construed as granting any rights or imposing any obligations on the Authority or the Secretary of State. The Authority's and the Secretary of State's discretion in this matter will not be fettered by any statements made in this letter or the attachment.

The need for NTS and DN GT's to be granted an exemption from Section 5(1) (c) of the Gas Act 1986

To support a divested industry structure whereby gas transporters make arrangements with each other for gas to be introduced into or taken out of a pipeline system. NTS and DN GT's will require an exemption from Section 5 (1) (c) of the Gas Act (an exemption). The provisions of such an exemption shall be clearly defined and limited in scope to support the offtake arrangements.

In June 2004² Ofgem consulted on the arrangements that would need to be in place between the NTS and offtakes from its system (both DNs and other NTS direct connects such as power stations, chemical plants, and interconnectors). This consultation followed extensive discussions within the industry workgroups. In Ofgem's June 2004 document four options were presented, these are set out below:

- ◆ **Option 1- Transco's initial proposal.** This option was proposed by Transco on the basis that it most closely reflects existing arrangements within Transco. It therefore was designed to formalise current internal arrangements, and gave the NTS a central role in the determination of NTS exit capacity levels.
- ◆ **Option 2 – DN booking model.** This option gave a central role in the arrangements to the DNs and NTS direct connects, with the NTS providing the level of capacity requested by its users. This option had two variants, which differed in terms of the payment flows between participants.

² National Grid Transco – Potential sale of gas distribution network businesses. Offtake arrangements. Regulatory Impact Assessment. June 2004 131/04

- ◆ **Option 3 – Shipper and DN booking model.** This was a hybrid model, in which capacity requests can be made by shippers, and DNs make additional capacity requests to ensure offtake capacity is consistent with the 1 in 20 obligation.
- ◆ **Option 4 – Shipper booking model.** This option gave shippers the responsibility for booking NTS capacity. Under this option, the 1 in 20 obligation is removed from DNs.

It has become evident that all options considered in the offtake RIA require an exemption with the exception of the shipper booking model - Option 4. This is because all other options, to some extent, require NTS and DN GT's to be entering into arrangements with each other for gas to be introduced into or taken out of their respective pipeline systems.

In August 2004, following careful consideration of respondents views the Authority issued a conclusions document³. In that document the Authority set out that, of all the different options outlined in the offtake RIA, Option 2 was the most appropriate for implementation as part of the DN sales process, if the Authority considered that DN Sales should proceed. NGT are therefore in the process of applying to the Secretary of State for an exemption to support the Authority's decision on the offtake arrangements.

To consider NGT's application for an exemption Ofgem/DTI have jointly been considering the process that will be necessary to enable the Secretary of State to consider whether such an exemption can and should be granted. The new indicative timetable includes these considerations.

Indicative regulatory timetable

In setting out this timetable and process, it is important to note that DN Sales is a commercial transaction of National Grid Transco (NGT) that requires regulatory approval. As such, several elements of the timetable are necessarily dependent upon the commercial decisions of NGT. NGT is planning to set out its overall timetable for the transaction at the DISG meeting on 15 October 2004. This will include NGT's indicative timetable for the resolution of issues associated with the changes to the Network Code and the development of the offtake arrangements.

The updated indicative Ofgem/DTI regulatory timetable attached to this note is subject to risks. Ofgem is committed to working with the DTI, NGT and the industry on all issues associated with DN sales in accordance with the attached timetable.

Ofgem intends to discuss the indicative timetable at the Development & Implementation Steering Group meeting on 15 October 2004. Anyone who wishes to join Ofgem's DN sales workgroups, or who wishes to attend a particular meeting, should contact Tracey Hunt on 0207-901-7356.

If you have any questions regarding this letter please do not hesitate to contact me on the above number. Jessica Hunt on extension 7431 will also be pleased to help.

³ National Grid Transco – Potential Sale of gas distribution network businesses. Offtake arrangements. Conclusions document on framework. August 2004 199/04.

Yours sincerely

Sonia Brown
Director, Transport

DN sales project indicative regulatory timetable

