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To: Interested Parties

**Sale of NGT's Local Gas Distribution Networks (DNs): Issue of an exemption from a shippers licence**

This joint DTI/Ofgem letter aims to set out the current position with regard to the request for a limited exemption from the need to hold a shippers licence for the operators of the National Transmission System (NTS) and the DNs.

In May 2003, National Grid Transco plc (NGT) announced that it would consider the sale of one or more of its DNs, which are currently assets held by Transco, a fully owned subsidiary of NGT. In the event of such a DN sale, the current understanding is that Transco would retain responsibility for the operation of the NTS and its retained DNs. The DNs being sold would result in a number of additional industry players being created who would be responsible for the operation and management of a number of the local gas distribution networks.

In August 2004, NGT reached agreement on the sale of four of its DNs. Also in August 2004, the Gas and Electricity Markets Authority made a decision on the offtake arrangements required to be in place in a post-sales scenario. Following publication of Ofgem's decision document on the offtake arrangements between the NTS and DNs post sales, Transco became aware that all of the options considered, with the exception of a shipper booking model, would require an exemption from section 5 (1) (c) of the Gas Act 1986.

The Gas Act requires gas transporters (i.e. those involved in transporting gas around GB in pipes) and shippers (i.e. those who buy gas from producers and sell it to users and/or suppliers and who arrange for gas to be transported) to have, respectively, a gas transporter and a gas shipper licence. However, the Act also prohibits any one company from having both types of licence. The exemption, if granted, would allow the NTS and the DNs to enter into

arrangements with each other for gas to be introduced into or taken out of their respective pipeline systems without requiring a shipper licence.

The scope of the exemption would be limited, only allowing the NTS and the DNs to comply with the arrangements incorporated within the offtake arrangements proposed in the event of DN sales. Neither Transco's NTS nor the DNs would be permitted to undertake any other shipper activities pursuant to the exemption. The current functions that shippers perform under the Gas Act would therefore be maintained and shipping would continue to be a competitive and distinct activity. Therefore, were this exemption to be granted a clear delineation between gas transporter and gas shipper arrangements would remain.

The Secretary of State is currently minded to grant this exemption. This is believed to be in line with the Secretary of State's principal objective of protecting the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition. The Department anticipates that this sale could facilitate competition and improve the efficiency and workings of the gas market.

The Department is currently consulting others in Government with an interest in this issue. Thereafter, the Secretary of State aims to publish an exemption order with a consultation document and partial regulatory impact assessment. There will then be a period of 28 days during which representations can be made to the Secretary of State specifically on the exemption order. As well as this consultation, the Department, with Ofgem, will table the exemption order for discussion at one of Ofgem's regular Development and Implementation Steering Group meetings which are open to all interested parties. The Department is also happy to meet any stakeholders on a bilateral basis to discuss the exemption order.

This letter and the current "minded to" position with regard to the exemption order is without prejudice and in no way fetters any future decisions the Secretary of State, the Gas and Electricity Markets Authority, and the Health and Safety Executive must make with regard to the proposed DN sales.

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