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Dear Sonia,

Licensing consultation : Next Steps

With respect to the above consultation, there are a number of key issues on which NGT wishes to comment, in addition to more detailed responses on the licence drafting. Our response is therefore split into two parts accordingly.

There are a number of issues that are relevant to licensing but subject to ongoing discussions. NGT will of course make representations on these matters through the appropriate fora as these arise.

Part I - Key issues

1 Agency

We do not agree with the proposal that the scope of the Agency and subcontracted services should be included in the Uniform Network Code (UNC).

The current drafting of the proposed licence condition would allow for shippers to directly amend the scope of the Agency services contract and NGT has argued consistently that this is not appropriate.

Structurally, the gas transporters (GTs) have the obligation to deliver Agency services. Those obligations will in future exist in the UNC and the GT licences. The Agent is of course not licensed. The GTs must therefore, be able to effectively manage their relationship (and their costs) with the Agent. The means by which the GTs satisfy these obligations is through the Agency services contract; this is a subcontracting arrangement. A fundamental issue arises if the scope of this subcontract is placed in the UNC; this would undermine the ability of the GTs to retain control of that relationship. This will undermine and blur the important principles of accountability and regulatory clarity.

NGT agrees in principle that shippers should be allowed to raise modifications on the services that the GTs provide to shippers but not to the Agency services agreement. This can only be achieved by keeping the Agency services agreement outwith the UNC. It should be noted however, that such modifications may have the consequential effect of causing the gas transporters ("GTs") to amend their contract or issue new instructions to the Agency.

Even with restriction of shipper modifications to UNC, there is an issue with cost allocation and control. GTs currently (and for the remainder of this price control period) have fixed revenue for the provision of Agency services. This creates a misalignment of incentives because shippers do not own the financial consequences of any changes that would expand the scope of these services. Alignment of incentives is a key driver for efficient behaviour. Longer term, it is expected that shippers will own the financial consequences of any scope expansions.

It is NGT's view therefore that this matter should be addressed at the time of the next price control and in the intervening time, the scope of the Agent's services to the GTs should be modifiable only by the GTs, with shippers able to modify the rules of UNC to effect any changes that are required.

2 Governance of transportation charging arrangements

NGT supports the proposed role of the Joint Office to administer changes to transportation charges and charging methodologies for all Distribution Networks ("DNs") and NTS.

We consider that it is appropriate to place a reasonable endeavours obligation to limit DNs to a maximum of two changes in their administered charges per year and on 1 April and 1 October, noting that this obligation is subordinate to the best endeavours obligation not to over recover.

With regard to the frequency of changes to charges and charging methodologies, NGT has argued that the NTS should not be restricted to twice per annum changes or on specified dates. The NTS is subject to factors that trigger changes (such as the NTS entry capacity auctions) that have caused volatility in NTS revenues such that more frequent changes (and on different dates to those proposed) are necessitated in order for the best endeavours obligation not to over-recover to be met.

NGT notes Ofgem's initial view but remains of the opinion that it is unnecessary to place the same restriction on non-administered prices e.g. auction reserve prices. The network code clearly sets out auction and reserve price timings and processes and there is the potential for timing mismatch and less efficient reserve price setting if reserve prices are included in this provision.

If reserve prices are to be included in the reasonable endeavours obligation then a transitional arrangement would be required in order to enable us to introduce exit reserve prices after hivedown for the first auction in September 2005.

NTS transportation constrained LNG credits are currently changed on 1st May, which is timed to allow for commercial decision-making process and the physical liquefaction process. We suggest that the ability to make a 1st of May change is retained as long as the constrained credits continue.

Restricting the number of changes in charges will increase the likelihood of the NTS under or over recovering its regulated income by limiting our ability to manage the process. Accordingly we propose the introduction of a dead band for the NTS licence, with a

standard interest rate, NGT has said that 5% is appropriate for NTS SO and 2% for the NTS TO.

3 Governance of Network Code and Offtake Arrangements

NGT supports the concept of the commercial rules that relate to the offtake of gas at all NTS Exit points residing in UNC.

Furthermore, we agree that the more technical operator-to-operator arrangements should reside in separate agreements between NTS and the DNs analogous to the NExA agreements that currently exist between the NTS and connected parties. These technical arrangements referred to as the NTS/DN Operator Arrangements will represent a set of common provisions to which the contractual arrangements would refer and would be supported by site specific schedules necessary to give effect to the arrangements for each DN. A common set of provisions with common modification rules will support transparency and consistency going forward and be visible to all parties. To complement these proposals, the UNC will include an additional section defining the scope of the NTS/DN Operator Arrangements in a manner analogous to the way that the current network code deals with NExAs.

4 System security – emergency services coordination

The issue of ensuring attendance to reported emergencies on boundaries is effectively regulated through the DN gas transporter safety cases governed by the Gas Safety (Management) Regulations. We consider this to be the appropriate place for this activity to be regulated.

In view of this, NGT welcomes Ofgem's decision not to include a licence condition to cover this activity, this would have the potential to lead to uncertain standards through lack of clarity.

5 System security – first response service to iGTs

NGT welcomes Ofgem's proposal not to alter existing licence obligations pending an overall review.

6 System security – First response emergency services to NTS

NGT welcomes Ofgem's initial conclusion favouring a new DN licence obligation requiring DNs to provide this service to the NTS.

7 Pipeline security standards

In the case of the NTS, the capacity auctions will provide information on the need for exit capacity, backed by firm financial commitments from connected parties. Inevitably, these market signals will be supplemented with other information such as knowledge of forthcoming developments that have yet to bid into auctions. If such information were to be ignored, there is a risk that the system would be developed in a piecemeal and hence inefficient manner. Such a development could then be considered to breach our general obligation to develop an efficient system. We believe that the 1 in 20 obligation will provide helpful clarity on the extent to which such additional information should be used in developing the network. Furthermore, we believe that it would be inappropriate to review the 1 in 20 obligation, for example moving towards a "peak aggregate hourly demand for gas" for two reasons. If the NTS security standard is set to a more stringent standard than

the DN standard, this will risk undermining the auctions process, as the NTS could be obliged to provide the capacity in any case. Secondly, any strengthening of the security standards would need time to develop and have implications for both the funding of, and time taken to complete, any associated investments. Such a change would best be handled via the price control review process.

8 Price controls and incentive arrangements

We support Ofgem's proposal not to reopen Transco's price controls so that overall the amount of money recovered from customers by GT's will be the same over the remainder of the price control period.

We note that Ofgem is proposing that there should be an incentive scheme applying to DNs to encourage efficient investment decisions by network owners and that these incentive arrangements will be supplemental to the price control arrangements and will be considered in detail in a separate consultation document. We will therefore comment on any proposed incentive arrangements as part of the separate consultation on incentives.

In the meantime we have undertaken some work to look at the changes that would be required to the price control conditions irrespective of the introduction of any new incentive arrangements. The draft licence conditions have been sent through under a separate cover for Ofgem to consider. In relation to the draft licence conditions there are two particular elements that we would like to highlight:

1. The licence drafting provided is consistent with the concept of a customer safety net within the NTS price control condition. However, with respect to the customer safety net, NGT repeats the position stated in our response to the Final Impact Assessment, which demonstrates that none is required.
2. We have provided some alternative licence conditions to the drafting that appeared in the Section 23 consultation in relation to the summing of the DNK terms to work out what interest rate (I_r) should apply to the retained Networks. From the two alternatives provided we believe that the initial proposals contained in the Section 23 drafting remain the most appropriate as this reflects the drafting and principles in the current licence.

With respect to the customer safety net, based on the views we expressed in the Final IA response in relation to Ofgem's estimate of the benefits and costs of DN sales, we believe that net consumer benefits will remain significantly positive under any sale scenario. Accordingly we do not believe that a customer 'safety net' payment would be required to protect consumers' interests, even if only one new comparator were to emerge from the sale process.

9 System operator managed service agreements

NGT welcomes Ofgem's initial conclusion that SOMSAs should not be regulated.

10 Standards of performance – Customer survey obligation

NGT has input to the development of this licence condition with Ofgem in order to ensure the provision of information to Ofgem in respect of this important area of consumer concern. NGT is content with the last version seen.

We have also seen a version of the RIGs that are now broadly acceptable to us. The RIGs went out for informal consultation last Friday and we will be responding separately to this through that consultation in January.

11 Standards of performance - Connections

With the development of competition in the connections market since February 1999 and the prospect of new gas distribution network owners in 2005, the Enforcement Order (the Order) is no longer a viable prospect to protect connections customers in the future. A new regime is required and one that avoids the complexity of the previous framework as well as better meeting the needs of customers and competitive service providers in the longer term.

The industry workshop in July 2004 recognised those areas of the market where competition was problematic due to current legislation and public policy barriers, as well as those with more scope for development, particularly in the non-domestic market. The proposed standards build on those foundations and provide for adequate protection for customers where competition may be limited, as well as providing sufficient headroom to encourage competition, whilst providing a minimum level of protection in the non-domestic market.

The proposals provide the opportunity for all customers to be paid for every failure, 100% of the time; in contrast to the current arrangements that pay differing amounts and only when performance falls below a 90% level. This proposal is far more comprehensive than that currently in place with the Order and will benefit customers by providing time to deliver a much better overall quality of service in both pre and post acceptance activities.

NGT will respond fully to the points raised in this consultation on 7 January 2005 through the parallel connections consultation.

12 Business separation – separation of network monopoly businesses

NGT has however, stated consistently that the scope for undue discrimination by a network monopoly business is both narrower in scope and has inherently much lower potential to result in the adverse effects of monopoly abuse than the scope that exists in the very different relationship between network monopoly and competitive supply businesses.

NGT looks forward to working with Ofgem to develop appropriate arrangements in this area and will input further through the on going process of informal consultation, including in response to latest business separation licence drafting issued at DISG on 21st December.

13 Regulatory accounts

NGT acknowledges that the regulatory accounts are Ofgem's main source of information about regulated businesses. We therefore understand that Ofgem needs to ensure that the information that Ofgem will obtain is the right information for comparative and policing purposes.

Recognising that there is further work to do in this area to ensure that Ofgem is able to obtain the information that it legitimately needs and without unnecessary creation of additional costs, NGT will be making further comments in this area at the appropriate time.

14 Requirement for NTS to have direct consumer obligations (proposed A20 and A23)

We refer to our previous correspondence on this matter and summarise here for clarity.

A domestic customer, for all practical purposes, deals exclusively with the local DN, indeed, many are unaware of the existence of the NTS. In order to maintain clarity for the customer in interfacing with gas transporters we believe that all communications should be with the local DN. Clearly, in the extremely rare case where the problem was caused by the NTS, then the DN would raise the issue with transmission and relay the information to the customer. However, given the rarity of supply disruptions on the NTS this is less likely to happen than a customer making a complaint against the NTS when the problem lies with the DN. For the same reason, the same approach should apply in respect of any complaints regarding the 0800 number.

We therefore propose a system analogous to that of a shop having supplied faulty goods: the customer seeks redress from the shop, who can then raise the issue with his supplier if appropriate. This has the benefit of clarity for the customer, ensures that the DN always knows about a connectee who is unhappy with the service being provided and avoids the cost of the NTS producing and maintaining a suite of fit for purpose documents for dealing with domestic complaints.

As you can see, we are not arguing against domestic customers being able to raise complaints - just that this should be administered in the most efficient way.

In summary, therefore, we propose that only DNs should have these obligations and the caveats in A20 and A23 should remain.

Part II - Specific comments on the draft licence conditions

We set out below our comments on specific licence conditions. This unavoidably involves some repetition of the above comments but we hope that it is helpful to divide our comments in this way.

ASC4 – SSpc A4: Charging Gas Shippers – General

As explained above, we consider that it is appropriate to place a reasonable endeavours obligation to limit DNs and NTS to a maximum of two changes in their administered charges per year and on specified dates.

We do however remain of the opinion that it is unnecessary to place the same restriction on auction reserve prices (paragraph 2(a)(i)). The network code sets out clearly auction and reserve price timings and processes and there is the potential for timing mismatch and less efficient reserve price setting if reserve prices are included in paragraph 2(a)(ii).

If reserve prices are to be included in the reasonable endeavours obligation then a transitional arrangement would be required in order to enable us to introduce exit reserve prices after hivedown for the first auction in September 2005.

As noted above, NTS transportation constrained LNG credits are currently changed on 1st May in order to align with the LNG storage year. We suggest that the ability to make a 1st of May change is retained as long as the constrained credits continue.

ASC 9 – SSpC A11: Network Code

We suggest that the phrase “where the Authority otherwise consents” is replaced with “where the Authority agrees otherwise” in Paragraph 9c.

SSpC A12 – Joint Office Governance Arrangements

We consider that the administration of common systems arrangements (paragraph 1a iii) is outside the scope of the Joint Office’s role, and therefore suggest that this paragraph is deleted. If the JO does have a role in the administration of common systems arrangements (in addition to the Network Operator Representative and xoserve), we do not consider that it would be one that requires a licence condition.

SSpC A14: Common System Obligations

While we agree that system cost allocation needs to be robust and transparent, we do not consider that there is an activity based cost system that would support the requirements of Paragraph 1(b). We suggest that Para 1(b) (iii) is sufficient and “on an activity cost basis” (Para 1(b) (ii)) is removed.

We understand that the Authority will require to be served a copy of the Common Systems Agreement (CSA), but we do not see the necessity for wider publication of the CSA. For example, the CSA may contain material that could be sensitive such as IPR in future system investment and the appointment of the nominated Network Operators Representative. We suggest therefore that paragraph 3 is deleted.

We would prefer that the emphasis placed on continuity and commonality of the systems (paragraph 4), be placed rather on the compatibility and consistency of systems interfaces. This would provide more flexibility in developing the most efficient systems and service whilst ensuring compatibility in interfaces between GTs and Shippers.

SSpC A15: Agency

We suggest that Para 2 (iii) is sufficient and that Para 2 (ii) (activity cost basis) is removed. Please see comments above in respect to SSpC A14.

Paragraph 1 indicates that the scope of the Agency will be set out in the UNC, and Para 2 that the services sub-contracted to a service provider are set out in the UNC.

Since the UNC is modifiable, we have concerns regarding governance and suggest that the licence contains a general scope of Agency’s obligations. In addition, whilst the UNC should set out the obligations of the parties to the contract we do not consider that the modifiable UNC is the appropriate place to define which of those obligations a party must sub contract to a service provider or the definition of such sub contracting arrangements that Gas Transporters will subcontract to a service provider. Additionally the service provider will in fact provide additional services in helping the GTs meeting their licence obligations (eg receipt of connection / disconnection notices) that have no place in the UNC.

However, we support the principal that the scope of services be transparent and suggest that the drafting in the first lines of Paragraph 2 be amended to have the following effect:

“Where services are sub-contracted to a common service provider, the scope of such sub-contracting arrangements shall be communicated to [shippers], and”

Ofgem states in the consultation document (para 6.42) that there would be a condition stating that licensees cannot “opt out” of Agency Agreements. We note that there is currently no specific non opt out condition.

SSpC A17: General obligations in respect of gas transporters’ pipe-line systems

We agree that a condition is required to ensure that transporters act prudently and prevent prejudicial action to other transporters’ systems.

SC 16: Pipeline Security Standards

We note that the consultation document (para 5.187) describes the 1 in 20 obligation as being calculated on the previous 50 years of data. We believe that the licence condition should be consistent with the existing condition of “at least” 50 years of data. However, we consider that there should be a degree of flexibility in the number of years of data to be used so as to adapt to statistical trends such as climate change. We would therefore recommend that the condition be amended to allow for this.

ASC 17 – SSpC A19: Provision of Services for persons who are of a pensionable age

We suggest that the condition might be amended to allow the possibility of the GT not owning the meter that requires repositioning (Para 1(a)). For example, “.. transmitted to the licensee a request for the repositioning of a meter and service pipe owned by the licensee, or a service pipe owned by the licensee and a meter owned by another party”.

A20 and A23 – Obligations to domestic consumers

For the reasons set out in part 1, we propose that only DNs should have these obligations and the caveats in A20 and A23 should remain.

ASC 25 – SpC D3: Long term development statement (for DNs)

For DNs, Paragraph 7 line 4 refers to ‘paragraph 9’. We believe this should refer to Paragraph 6.

SpC C3: Long term development statement (For NTS)

In general, we refer to our previous communication to you on this subject but we summarise the main points of this below.

The consultation states incorrectly (Para 5.278) “Transco’s alternative proposal required a single co-ordinated 10-year statement to be prepared”. In line with our previous communication, we support Ofgem’s proposals that the NTS and DN licensees compile and produce their own individual 10 year statements for their networks.

The statements are not “consolidated” in an integrated sense, as we have advised and we therefore believe that any requirement for “linkages” between the NTS and DN statements would best be achieved by a series of links to the network operators’ websites.

We do not believe that a firm date within any formula year for publication of the statement is appropriate and this loss of flexibility may have the unintended result of precluding most recent information from which the industry would benefit.

ASC 30 - SSpc A30: Regulatory Accounts

In view of on-going discussions on the objectives of the regulatory accounting requirements, the best way to meet these and the form of associated licence conditions, NGT will make further representations and comments through this process.

ASC 39 – SSpc A33: restriction on the use of certain information and independence of the transportation business

As we have stated above, we do not consider that the electricity distribution and supplier market issues (monopoly – competitive business separation) reflected in the licence condition drafting are fully appropriate to gas distribution and transmission market (monopoly – monopoly business separation).

We see the need for wider exceptions to those listed in paragraph 2 of the new draft condition, as are reflected in paragraph 2 of the existing ASC39. As drafted, this might overwrite the consent that Ofgem granted under ASC 39 as part of the implementation of RGMA, allowing for Transco Metering to have continued access to a number of Transco IS systems that will need to continue. In addition, suppliers have requested that Transco Metering share information with Fulcrum to coordinate the installation of gas services and metering. We consider that the Authority should be given the flexibility to lift the restriction on sharing information, or to provide for the shipper / supplier to give consent to sharing certain information and therefore that the provisions permitting this in Transco’s existing licence should be preserved in the new licences.

SpC 47: Adjustment of de-minimis income cap to take account of new service agreements

Currently de-minimis caps are set on aggregate Transco plc turnover and investment. The current drafting appears to continue this arrangement.

Due to the difficulty of accurately projecting the levels of some service agreement revenues (in particular those with a large element of cost pass through in their charges), we suggest that it is most appropriate to specify the service agreements that will be allowed to generate revenue in excess of the current de-minimis caps rather than to state a specific limit on turnover or investment.

If, however, a financial limit on de-minimis “extensions” is to be set, we consider it more appropriate to define this through a “maximum revenue” level and to exclude the investment level criteria. Most services are provided on a cost reflective basis from existing resources, and there is therefore no meaningful definition of associated de-minimis investment. In addition, there is currently no meaningful investment denominator

since share capital, premia and consolidated reserves exist at Transco Plc level rather than GT business level.

SpC 26 - SSpC C4: Prohibited procurement activities

We note that SpC C4 requires review. For example the reference to 'Top up Manager' is now out of date.

SpC D8: Reform of distribution network interruption arrangements

The drafting to para 1 could be tightened up to make clear the intent for proposals to be developed, rather than implemented, by 1 April 2006.

Two small general points

There are two general points that should be noted :

1 Para 5.170 bullet 2 implies that the provisions contained within SSpC A11 are designed to govern the Agency and Joint Governance arrangements. We believe that this is unintentional and should refer to the UNC (as per the actual drafting).

2 Para 6.49: Correction – A14 should read A15.

The objective of this response is to provide constructive comments and input and therefore I hope that this letter is helpful. Please let me know if you would like to discuss any aspect of this letter.

Yours sincerely,

Chris Train
Director – Network Sales