

**National Grid Transco – Potential sale of gas  
distribution network businesses**

**Formal consultation under section 23  
and section 8AA of the Gas Act 1986**

February 2005

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# 1. Introduction

- 1.1. On 12 January 2005, the Gas and Electricity Markets Authority (the Authority) received an application from Transco plc<sup>1</sup> (Transco) under Special Condition 25A of each of four of the six gas transporter (GT) licences currently held by Transco and under section 8AA of the Gas Act 1986 (the Act). This application seeks consent from the Authority to transfer (in connection with National Grid Transco plc's (NGT) proposal to sell four of Transco's local gas distribution networks (DNs)) the four relevant DN GT licences to four wholly owned Transco subsidiary companies.
- 1.2. This document represents the formal consultation on the Authority's proposal to grant such consent to Transco and on the changes proposed as part of the:
- ◆ **section 8AA licence** transfer and modification process for the four relevant DN GT licences that NGT is proposing (as part of DN sales) to transfer from Transco to the four relevant wholly - owned Transco subsidiary companies; and
  - ◆ **associated section 23** modification process to change the two National Transmission System (NTS) and retained DN (RDN) GT licences, which will continue to be held by Transco after DN sales.
- 1.3. This document seeks to formally consult on the Authority's proposal to grant its consent to Transco and on the modifications which the Authority is proposing to make (as part of DN sales) to each of Transco's six GT licences (in terms of both content and structure) in order to ensure that customers interests are protected. Some of the proposed changes are modifications to Transco's existing licence conditions in order to ensure that these conditions are suitable for a divested industry. In addition, the Authority is proposing to introduce a number of new licence conditions into each of Transco's six GT licences to reflect the need for the creation of new obligations that are not currently covered.
- 1.4. As the proposed DN sales transaction is not a regulatory initiative but a commercial transaction by NGT, Ofgem intends only to modify the six GT

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<sup>1</sup> Transco plc is a wholly owned subsidiary of National Grid Transco plc.



licences currently held by Transco and not any other GT licences. However, in identifying the proposed modifications, Ofgem has given careful consideration to the potential impact on other GTs and in particular, has satisfied itself that no undue discrimination would be created through the proposals set out in this document. However, if any respondent considers that any proposals set out in this document would adversely impact upon them, Ofgem would welcome representations on this matter.

- 1.5. The statutory Notices are set out in Appendix 5 and Appendix 6 to this document. The appendices to this document contain the full text of the legal drafting proposed in respect of each of the six relevant GT licences. The statutory Notices and the legal drafting contained in the appendices to this document set out the text and effect of the licence modifications proposed by the Authority to the six GT licences currently held by Transco.
- 1.6. As this has been an ongoing and iterative process, in order to assist respondents, Ofgem has summarised in this document some of the key changes made to the proposed drafting since the last consultation document in November 2004. However, we have not described every single change made since that time. The commentary in this document should therefore be used as a general guide only. Respondents should note that whilst this document is intended to be helpful, it is important that the actual legal drafting set out in appendices is reviewed and considered in full.
- 1.7. In issuing this document it is important to make clear that after the Authority's decision in relation to DN sales on 20 January 2005, there can be no expectation on the part of NGT, Transco, potential shippers, suppliers, DN purchasers or any other interested parties as to any further decisions which the Authority may be required to take or any further consents which the Authority may be required to grant (including for the avoidance of doubt any decisions or consents which may be necessary pursuant to a condition precedent or a condition subsequent attached to the consents granted by the Authority on 20 January 2005) in relation to DN sales. The information in this document is not binding on the Authority. Nothing in this document is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion will not be fettered by any statements made in this document.

## ***Background***

- 1.8. Following NGT's announcement, in May 2003, that it would consider the sale of one or more of its DNs if it were to increase shareholder value, Ofgem initiated a programme of work to explore the potential costs and benefits that such a transaction may have for consumers<sup>2</sup>. Any sale of DN assets by NGT would require the consent of the Authority, the Health and Safety Executive (HSE) and the Secretary of State for Trade and Industry (the Secretary of State).
- 1.9. As part of this process, in September 2004<sup>3</sup> Ofgem issued its initial analysis of the modifications to the six relevant GT licences (the September document), in terms of both content and structure, that would be required to ensure that the regulatory framework protects the interests of customers within a divested industry structure.
- 1.10. This was followed, in November 2004, by a 'next steps' document<sup>4</sup> (the next steps document), which set out respondents' views to Ofgem's September document, and Ofgem's revised proposals in light of these views. This document also set out the next steps and invited views on both:
- ◆ a formal section 23 Notice regarding the separation of the price control provisions between each of Transco's six GT licences; and
  - ◆ an informal consultation on further licence modifications (both in terms of content and structure) which would be proposed at the section 8AA stage (along with an associated section 23 Notice at that time) should the Authority grant its conditional consent to DN sales at its meeting in January 2005.
- 1.11. On 20 January 2005, a duly convened meeting of the Authority met to consider Transco's applications for consent to dispose of four of its relevant DNs. After

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<sup>2</sup> Appendix 1 gives details of Ofgem's regulatory process associated with NGT's proposed DN sales. This includes a timeline of the commercial transaction and the associated regulatory process.

<sup>3</sup> *National Grid Transco – Potential Sale of gas distribution network businesses, Initial thoughts on restructuring Transco plc's Gas Transporter Licences, Consultation document, Ofgem September 2004 215/04.*

<sup>4</sup> *National Grid Transco – Potential Sale of gas distribution network businesses, Licensing: Next Steps Formal consultation under Section 23 and informal consultation under Section 8AA of the Gas Act 1986, Consultation Document, November 2004 263/04.*

careful consideration of the applications and respondents' views to the various consultations initiated by Ofgem, the Authority granted its consent to Transco under Amended Standard Condition 29 of Transco's original GT licence<sup>5</sup> to hive-down the four relevant DNs to four wholly owned Transco subsidiary companies. It should be noted that the Authority's consent was granted on a conditional basis. These conditions relate to, amongst other things, the modification of each of Transco's six GT licences.

- 1.12. Under the consent granted by the Authority, Transco is required to satisfy a number of conditions prior to hive-down of the relevant DN assets from Transco to its four relevant wholly owned subsidiary companies. In addition, Transco is required to satisfy a number of conditions subsequent to hive-down but prior to completion of the sale of shares in the four relevant wholly owned Transco subsidiary companies to third party purchasers. A detailed discussion of the conditions imposed by the Authority as well as the consent direction can be found in the Authority's February 2005 decision document<sup>6</sup>.
- 1.13. On 27 January 2005, the Secretary of State also granted her consent to Transco pursuant to Amended Standard Condition 29 of Transco's original GT licence.
- 1.14. On 1 February 2005, (pursuant to the formal section 23 Notice contained in the next steps document) the Authority issued a direction to modify the price control conditions in each of Transco's six GT licences. These modifications were required to achieve revenue separation between Transco's NTS and each of the four DNs which are proposed to be disposed of by Transco (the IDNs) and each of the four DNs which are proposed to be retained by Transco (the RDNs). As a result, four of the GT licences currently held by Transco (and which are now proposed to be transferred to the four relevant wholly owned Transco subsidiary companies) relate respectively only to each of the four IDNs, one of the GT licences currently held by Transco relates only to the four RDNs, and the original Transco GT licence relates only to the NTS.

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<sup>5</sup> *National Grid Transco - Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks*, Authority Decision, 21/05.

<sup>6</sup> *National Grid Transco - Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks*, Authority decision (21/05). See Appendix 2 for the Authority's consent direction.

## ***Respondents' views***

- 1.15. In total Ofgem received twelve responses to the next steps consultation document. These respondents included Transco (the licensee), all three potential purchasers, and shippers/suppliers. No responses were confidential. All responses can be found on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). In addition, Ofgem received further views from the industry and other interested parties as part of the numerous DN sales Development and Implementation Steering Group (DISG) meetings. The key comments have been included in the relevant sections of this document, and minutes of certain of the DISG meetings are attached in Appendix 2. It is important to note that the minutes of the DISG meetings attached in Appendix 2 are merely intended to be a high-level summary of some of the key issues which were discussed at DISG meetings.

## ***Structure of this document***

- 1.16. This document is structured as follows:
- ◆ Chapter 2 sets out the background including the regulatory framework relevant to the proposed modifications of Transco's six GT licences;
  - ◆ Chapter 3 sets out some of the key issues from respondents' views on the next steps document and sets out the way forward on each of these issues;
  - ◆ Chapter 4 gives respondents' views and the way forward for each of the existing licence conditions in Transco's six GT licences;
  - ◆ Chapter 5 gives respondents' views and the way forward for each of the proposed new licence conditions. This chapter also details where the need for new licence conditions have been identified since the next steps document; and
  - ◆ Chapter 6 explains the proposed way forward.
- 1.17. In addition, there are a number of appendices (which have been published separately in conjunction with this consultation document). These are:

- ◆ Appendix 1 – DN Sales timeline;
- ◆ Appendix 2 – Minutes of DISG meetings 29 to DISG meeting 35;
- ◆ Appendix 3 – List of respondents to the next steps document;
- ◆ Appendix 4 – Mapping of licence conditions;
- ◆ Appendix 5 – Section 8AA Notice of Ofgem’s proposal to grant its consent to the transfer of the four GT licences (in respect of the four IDNs) the four relevant wholly-owned Transco subsidiary companies and the proposed changes to these licences;
- ◆ Appendix 6 - Section 23 Notice of changes to the two GT licences (in respect of the NTS and RDNs) which are proposed to be retained by Transco;
- ◆ Appendix 7 –Proposed licence drafting of Standard Conditions;
- ◆ Appendix 8 - Proposed licence drafting of Standard Special Conditions and Special Conditions:
  - ◆ Appendix 8A: Standard Special Conditions applicable to all NTS and DN Licensees: Part A;
  - ◆ Appendix 8B: Standard Special Conditions applicable to all NTS Licensees: Part B;
  - ◆ Appendix 8C: Special Conditions applicable to the Licensee (NTS): Part C;
  - ◆ Appendix 8D: Standard Special Conditions applicable to all DN Licensees: Part D;
  - ◆ Appendix 8E: Special Conditions applicable to the Licensee (DNs): Part E:
    - ◆ Appendix 8E (1): Special Conditions applicable to the RDNs only;

- ◆ Appendix 8E (2): Special Conditions applicable to the North of England DN only;
  - ◆ Appendix 8E (3): Special Conditions applicable to the Scotland DN only;
  - ◆ Appendix 8E (4): Special Conditions applicable to the South of England DN only; and
  - ◆ Appendix 8E (5): Special Conditions applicable to the Wales & West DN only.
- ◆ Appendix 9 – DTI position paper on policy regarding the treatment of independent gas networks.

### ***Views invited***

1.18. Ofgem invites views on all of the issues raised in this document within the following timescales:

- ◆ for the formal consultation on the section 8AA proposal to grant consent to the transfer of the four relevant DN GT licences (in respect of the IDNs) from Transco to the four relevant wholly owned Transco subsidiary companies and the proposed modifications to such licences, Ofgem requests that respondents submit their views within the two month statutory consultation period ending at 5pm on 15 April 2005; and
- ◆ with respect to the formal consultation on the section 23 proposed modifications to the two GT licences (in respect of the NTS and the RDNs) that will remain within Transco, whilst Ofgem notes that the statutory consultation period should be no less than 28 days, it believes that, in this case, the period for consultation should also be two months, consistent with the Section 8AA consultation and ending at 5pm on 15 April 2005.

- 1.19. Responses should be addressed to:

Sonia Brown

Director, Transportation

Office of Gas and Electricity Markets

9 Millbank

London SW1P 3GE

- 1.20. Electronic responses may be sent to [Helen.connolly@ofgem.gov.uk](mailto:Helen.connolly@ofgem.gov.uk).
- 1.21. Respondents are requested, as far as possible, to provide non-confidential responses. Ofgem would also prefer for non-confidential responses to be sent electronically so that they can be placed on the Ofgem website. Respondents are free to mark their reply as confidential if they wish.
- 1.22. If you wish to discuss any aspect of this paper please do not hesitate to contact Helen Connolly (telephone 020 7901 7267) who would be pleased to help.

## ***Way forward***

- 1.23. This document represents the next step in the process towards developing a proposed licence structure which would be necessary to ensure that the interests of customers are protected in a divested industry structure after any DN sales.
- 1.24. In addition to this document, Ofgem will be consulting in March 2005 on the development of the Uniform Network Code (UNC) proposals, presently being developed by Transco and the industry.
- 1.25. Ofgem has recently issued an initial thoughts document in relation to the enduring offtake arrangements incentive scheme.<sup>7</sup> Following this, Ofgem will be consulting on its initial proposals for the interim offtake arrangements incentive scheme in March.

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<sup>7</sup> See *National Grid Transco – Potential sale of gas distribution network businesses, Initial thoughts on enduring incentive schemes supporting the offtake arrangements*, Ofgem, February 2005.

- 1.26. Subject to consideration of respondents' views, Ofgem intends to introduce the proposed modifications set out in this document to Transco's six GT licences on 1 May 2005 through a direction to be issued on or around 25 April 2005. This direction will only be made if other relevant conditions attached to the Authority's consent granted on 20 January 2005 in relation to DN sales are satisfied.
- 1.27. After the hive-down of Transco's four relevant IDNs into the four wholly owned subsidiary companies, and prior to the completion of the sale of the shares in such companies to third party purchasers, Ofgem will conduct a further consultation on modifications to each of the six relevant GT licences. It is envisaged that this will include, amongst other things (and without limitation), modifications to introduce the interim incentive schemes for NTS and DN GTs as well as changes required as a consequence of respondents' views or other related simultaneous consultations.
- 1.28. A more detailed discussion of the way forward is set out in Chapter 6.



## 2. Background

- 2.1. This chapter sets out some of the key aspects of the regulatory framework including some of the key duties and obligations on the Authority and gas transporters (GTs) that need to be considered when developing a proposed licensing regime to protect the interests of customers within a divested industry structure in the event that DN sales proceed. The description of the regulatory framework includes an outline of the current licence framework including relevant sections of the Gas Act 1986 (the Gas Act).
- 2.2. This chapter also explains the process to date including both the September document and the next steps document and the consultation undertaken with industry participants through DISG meetings.
- 2.3. This chapter therefore outlines:
- ◆ the regulatory background;
  - ◆ the structure of the licences held by Transco plc; and
  - ◆ the process to date.

### ***Regulatory background***

- 2.4. This section sets out some of the key elements of the regulatory framework that are relevant in the context of the proposed DN sales as follows:
- ◆ the Gas Act; and
  - ◆ Transco's GT licences.

### ***The Gas Act***

- 2.5. The Gas Act provides for the regulation of the onshore gas regime in Great Britain and for the separate licensing of GTs, gas shippers and gas suppliers. This section sets out some of the key relevant areas of the Gas Act for consideration in relation to the duties of the Authority and of gas transporters.

## **Duties of the Authority**

- 2.6. Section 4AA of the Gas Act provides that the principal objective of the Authority in carrying out its functions under the Gas Act is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate, by promoting effective competition between those engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas. Consumers for these purposes include both existing and future consumers.
- 2.7. In carrying out its functions under the Gas Act in a manner which is best calculated to further the principal objective, the Authority is required to have regard to the following:
- ◆ the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met; and
  - ◆ the need to secure that licence holders are able to finance the carrying on of the activities which they are authorised or required to perform.
- 2.8. In performing its duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas as well as customers generally.
- 2.9. The Authority may, in carrying out any of its functions, have regard to the interests of consumers in relation to electricity, telecommunications, and water and sewerage services, which are affected by the carrying out of those functions.
- 2.10. The Authority must carry out its functions in the manner it considers is best calculated to:
- ◆ promote efficiency and economy on the part of authorised persons and the efficient use of gas conveyed through pipes;
  - ◆ protect the public from dangers arising from the conveyance of gas through pipes or the use of such gas;
  - ◆ contribute to the achievement of sustainable development; and
  - ◆ secure a diverse and viable long term energy supply.

- 2.11. The Authority must also have regard to the effect on the environment of activities connected with the conveyance of gas through pipes.
- 2.12. In carrying out its functions in accordance with the above objectives and duties, the Authority must have regard to:
- ◆ the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and
  - ◆ any other principles appearing to the Authority to represent the best regulatory practice.
- 2.13. In addition, the Authority must, in carrying out its functions, have regard to any guidance issued by the Secretary of State about the making by the Authority of a contribution towards the attainment of any social or environmental policies set out or referred to in such guidance.
- 2.14. The Authority is also required to bear in mind when developing policy proposals that any such proposals should be consistent with European Union gas legislation on, amongst other things, conditions of access to gas transmission networks.

### **Duties of Gas Transporters**

- 2.15. In addition to meeting the Authority's statutory duties, the licence framework following DN sales must permit the NTS and DNs to fulfil their own statutory obligations under the Gas Act as GTs. These include the duty of each GT to:
- ◆ develop and maintain an efficient and economical pipeline system (section 9(1)(a) of the Gas Act);
  - ◆ facilitate competition in the supply of gas (section 9(1A) of the Gas Act); and
  - ◆ avoid any undue preference or undue discrimination in the terms on which it undertakes to convey gas (section 9(2)(b) of the Gas Act).

## ***The licensing framework***

- 2.16. Sections 5 to 8A of the Gas Act provide for the licensing of activities relating to gas. These include the licensing of GTs, gas shippers and gas suppliers. Unlike the Electricity Act 1989, the Gas Act does not provide for the separate licensing of transmission and distribution activities. Section 7 of the Gas Act sets out the provisions relating to the licensing of GTs. Section 8 provides for standard conditions of licences.
- 2.17. Section 23 of the Gas Act sets out the provisions relating to the modification of licence conditions for which there are a number of different procedures. These are set out below:
- ◆ **Collective licence modification (CLM).** The CLM procedure deals with the modification of standard conditions under section 23(1)(b) and section 23(7) of the Gas Act. The Authority may bring forward proposals for licence modification and the CLM arrangements enable relevant licence holders who are not content with a proposed modification to a standard condition to register their formal objection. Numerical tests determine the level of objections to a proposal which is measured against a blocking minority threshold prescribed by the Secretary of State. In the absence of the blocking threshold being met, the Authority may direct that a proposed modification be made; and/or
  - ◆ **Individual consent.** The individual consent process as set out in sections 23(1)(a) and 23(6) of the Gas Act requires the Authority to gain the consent of each relevant licensee prior to modification of the licence under this process. This process can be used either in relation to amending standard conditions for individual licensees or amendments to special conditions for individual licensees. Where a standard condition has been modified by individual consent, it ceases to be subject to the CLM procedure to the extent that it has been modified.
- 2.18. In the absence of obtaining consent either through the CLM procedure or the individual consent of the relevant licensee, the Authority may refer the matter to the Competition Commission for resolution. The Gas Act provides the

mechanism by which licences can be modified in the circumstances of such a reference.

- 2.19. Under section 8AA of the Gas Act a licence is capable of being transferred by the licence holder with the consent of the Authority, in accordance with the section, and any terms of the licence relating to its transfer. This may include conditions which must be complied with before the licence can be transferred. Consent may be given subject to compliance with such modification or other conditions as the Authority considers necessary.

### ***Transco plc's GT licences***

- 2.20. Following the direction of the section 23 modifications, which were formally consulted upon in November (the next steps document), Transco is the holder of six GT licences<sup>8</sup>; one for the NTS, one for the four DNs which will be retained by Transco plc (the RDNs), and four for each of the four DNs that Transco is proposing to sell. Each of these licences is largely identical, with the exception of the price control related conditions, which, following the section 23 modifications (directed on 1 February 2005), are specific to the NTS and each DN.
- 2.21. Between them, Transco's six GT licences cover the operation of its high pressure transportation business, largely the NTS, and its lower pressure distribution business (mainly the DNs). Each of these licences also contains provisions, which relate to LNG Storage arrangements and metering. Looking at the conditions in Transco's six GT licences, it is clear that some conditions relate to its:

- ◆ NTS operations;
- ◆ DNs operations; and

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<sup>8</sup> Prior to DN sales, Transco held only one GT licence and all gas transportation assets owned by Transco were operated pursuant to this licence. In November 2004, in connection with DN sales, the Authority granted five additional GT licences to Transco. The new licences were largely identical to the original Transco GT licence. On 1 February 2005, the Authority issued a direction modifying each of Transco's six GT licences so that the original Transco GT licences relates to the NTS only; four of the new additional GT licences relate respectively to the four DNs to be disposed of and one of the new additional GT licences relates only to the four DNs to be retained by Transco.

- ◆ both NTS and DN operations.

2.22. This reflects the fact that the NTS and DNs have, historically, been operated within a single legal entity (i.e. Transco plc) and under a single licence (i.e. Transco's original GT licence).

2.23. Transco's six GT licences have three types of conditions<sup>9</sup>. These are as follows:

- ◆ **Standard Conditions.** These are applicable to all holders of GT licences including independent gas transporters (IGTs)<sup>10</sup>, unless otherwise modified or specified. These conditions were designated by the Secretary of State in September 2001 and have been updated by Ofgem since that time through the CLM procedure (i.e. pursuant to sections 23(1)(b) and 23(7) of the Gas Act);
- ◆ **Amended Standard Conditions.** These are conditions where the wording of the standard condition has been amended with the consent of the relevant licensee (i.e. pursuant to sections 23(1)(a) and 23(6) of the Gas Act) to reflect a particular need or characteristic of the licensee. The amendments are not subject to the CLM procedure; and
- ◆ **Special Conditions.** These are specific to individual licensees and have been introduced with the relevant licensee's consent (i.e. pursuant to sections 23(1)(a) and 23(6) of the Gas Act) in order to reflect a particular need or characteristic of the licensee.

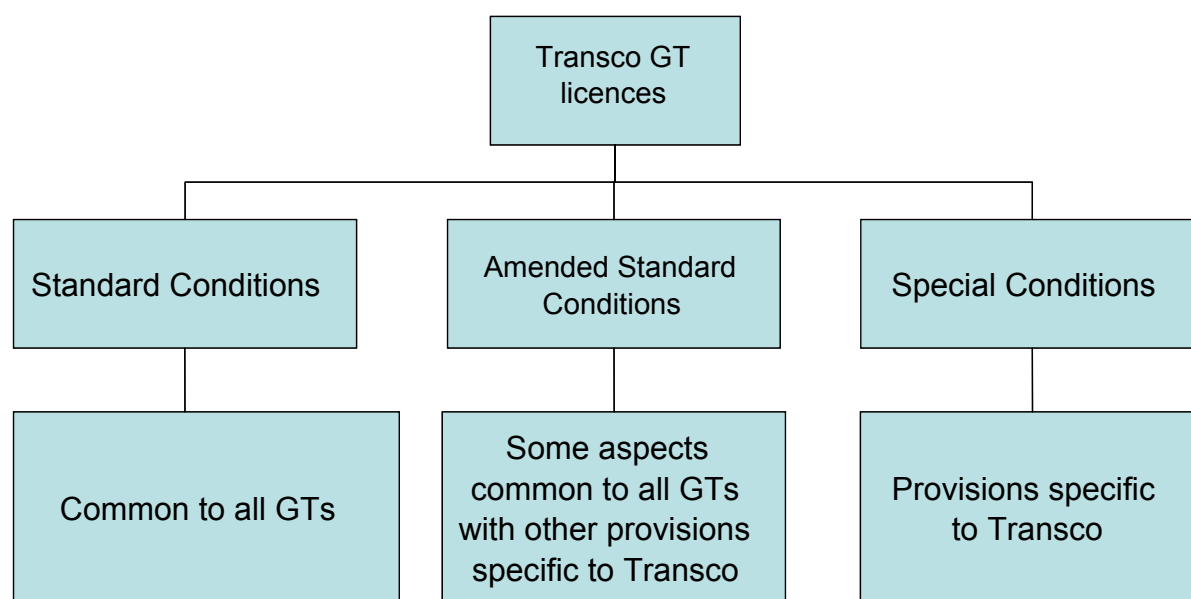
2.24. Figure 2.1 below illustrates the current structure of each of Transco's six GT licences.

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<sup>9</sup> The Gas Act refers only to "conditions" or "standard conditions" – the terms "amended standard conditions" and "special conditions" have been developed to differentiate between the types of conditions and the processes of modification applicable to them.

<sup>10</sup> IGTs are existing independent gas transporters which are not owned by Transco plc. These IGTs, in general, operate small scale networks which serve groups of domestic or industrial customers and are much smaller than any of the transmission or distribution networks owned by Transco plc. References to distribution networks (DNs) or Independent Distribution Networks (IDNs) within this document refer to the DNs currently owned and operated by Transco plc and those proposed for sale by Transco plc respectively.

**Figure 2.1: Configuration of Transco plc's existing GT licences**



2.25. All standard conditions in Transco's original GT licence and the five new additional GT licences are currently split into three sections, as follows:

- ◆ Section A of the standard conditions contains conditions relating to interpretation, application and payments;
- ◆ Section B of the standard conditions contains general provisions; and
- ◆ Section C of the standard conditions contains transport services obligations.

2.26. Conditions contained in Section C of the standard conditions are currently the only ones in the GT licence capable of being switched on or switched off (i.e. for the provisions to be active or not active over a particular period) by a direction of the Authority issued with the relevant licence holder's consent (pursuant to Standard Condition 2).

### ***Process to date***

2.27. This section provides an overview of the process that Ofgem has followed to date in relation to licensing issues. In particular, it provides an overview of:

- ◆ the consultation relating to the granting of five new additional GT licences to Transco;
- ◆ the September informal licence consultation document;
- ◆ the granting of five new additional GT licences to Transco;
- ◆ the Authority's decision with respect to legal separation;
- ◆ the Next Steps consultation document;
- ◆ the DTI position paper regarding the treatment of independent gas systems;
- ◆ the Authority's decision with respect to Transco's four applications under Amended Standard Condition 29 (Disposal of Assets) of its original GT licence to dispose of DN assets;
- ◆ the Secretary of State's decisions with respect to Transco's applications to dispose of DN assets and Gas Act exemptions;
- ◆ the direction to modify Transco's six GT licences, following the formal section 23 consultation within the Next Steps consultation;
- ◆ the incentives consultation; and
- ◆ the involvement of the industry workgroups throughout the process.

### ***Grant of licence consultation***

- 2.28. In the context of its proposed DN sales, in July 2004, Transco applied to Ofgem for eight new additional GT licences relating to the restricted geographical area associated with each of its DNs. The applications were submitted prior to the announcement by Ofgem that NGT would not have to legally separate each of the DNs it is proposing to retain (the RDNs) and, as such, eight new additional licences were requested in order to accommodate this possibility (i.e. a new licence in respect of each of its eight DNs).
- 2.29. Following Transco's application, in July 2004 Ofgem issued a notice under the Gas Act in relation to the potential grant of new additional GT licences to



Transco in connection with the proposed DN sales and invited views from interested parties regarding this proposal.<sup>11</sup> This consultation was open for a period of two months.

### ***September informal licence consultation document***

- 2.30. In September 2004, Ofgem issued an informal consultation document regarding the proposed restructuring of Transco's original GT licence and the proposed new additional GT licences.<sup>12</sup> This document stated that, subject to the consideration of respondents' views, Ofgem envisaged that at least five new additional GT licences would be granted to Transco to accommodate four potential independent gas Distribution Networks (IDNs) and Transco's RDNs.
- 2.31. This document invited views from interested parties in relation to the possible modifications to Transco's original GT licence and the five new additional GT licences (if granted) in the context of the proposed sale of one or more DNs by Transco. Ofgem considered that modifications, in relation to both the content and structure of these licences, would be required in the context of a potential DN sale to ensure that the scope of the regulatory framework was sufficient to support a divested industry structure, so that customers' interests were protected.
- 2.32. In the September licence consultation, Ofgem detailed that it would review the need to modify Transco's original GT licence and the five new additional GT licences as part of the DN sales process through:
- ◆ a section 23 Notice in November 2004;
  - ◆ a section 8AA consent Notice to the proposed transfer of four of Transco's new GT licences to four wholly owned subsidiary companies in February 2005 (and an associated additional section 23 Notice in relation to GT licences (in respect of the four RDNs and the NTS) which will be retained by Transco);

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<sup>11</sup> Notice issued under sections 7(5) and 8(4) of the Gas Act 1986, Ofgem, July 2004.

<sup>12</sup> National Grid Transco – Potential sale of gas distribution network business, *Initial Thoughts on restructuring of Transco plc's Gas Transporter Licences, Consultation document*, Ofgem, September 2004, 215/04.

- ◆ the conditions attached to the Authority's consent to dispose of the four relevant DNs under Amended Standard Condition 29 of Transco's original GT licence (Disposal of Assets); and
- ◆ a further section 23 consultation (if required), prior to completion of the proposed sale of shares in the four relevant wholly owned subsidiary companies to third party purchasers, to reflect the development of arrangements to support a post-DN sales environment.

- 2.33. In the September document, Ofgem conducted an initial analysis of each of the standard conditions, amended standard conditions and special conditions in Transco's original GT licence, to assess the extent of amendments that would be required to incorporate the implementation of regulatory arrangements necessary to protect the interests of customers within a divested industry structure. In this regard, Ofgem undertook an evaluation of the licence conditions in Transco's original GT licence that, in a divested industry structure, would be appropriate to transmission activities (which would apply to the NTS), distribution activities (which would apply to the RDNs and the IDNs and both transmission and distribution activities (which would apply to the NTS, RDNs and IDNs).
- 2.34. Ofgem also considered whether new licence conditions would need to be introduced into Transco's original GT licence and the five new additional GT licences to reflect a divested network structure and consulted upon the possible provisions that could be implemented to accommodate metering and LNG Storage arrangements going forward.
- 2.35. This preliminary analysis concluded that a significant number of modifications (in relation to content and structure) would be required to Transco's original GT licence and the five new additional GT licences to address the regulatory issues associated with a potential DN sale. This was a direct consequence of the integrated nature of Transco's business which was reflected in its original GT licence.<sup>13</sup>
- 2.36. It is noted that following the release of the September document there were numerous consultative discussions of licence related issues at DISG meetings.

## ***Grant of licence decision***

- 2.37. Following consideration of responses received in relation to the Notice issued, on 5 November 2004 the Authority (without in any way fettering its discretion in relation to the proposed transaction) granted five new additional GT licences to Transco.<sup>14</sup> The five new additional GT licences were approved on the basis that they could be revoked in the event that the proposed disposal of DN assets from Transco to its four wholly owned subsidiary companies does not proceed. The grant of five GT licences reflected the Authority's decision not to insist on legal separation between each of Transco's RDNs and, as such, these entities will be retained under one DN-GT licence within Transco. It also accommodated Transco's commercial decision to sell four of its DNs. Transco formally withdrew its remaining three applications.
- 2.38. The five new additional DN-GT licences were granted in substantially the same form as Transco's original GT licence. As at the date of the grant of the five new additional GT licences, all gas transportation assets owned by Transco were operated pursuant to its original GT licence. Following the grant of these additional licences, the five new additional GT licences, whilst active, did not relate to any particular gas transportation assets owned or operated by Transco. However, following a direction of the modifications proposed in the next steps document (issued on 1 February 2005), four of the five new additional GT licences relate respectively to the four DN assets to be sold; one of the new additional GT licences relates only to the four DN assets to be retained by Transco and Transco's original GT licence relates only to the NTS assets. These section 23 modifications are discussed in further detail below.

## ***Legal separation***

- 2.39. The conclusions document on offtake arrangements outlined the Authority's position that it was minded to require Transco to undertake legal separation and

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<sup>13</sup> As explained above, Transco's original GT licence covers a number of different activities including: transmission; distribution; LNG storage; and metering.

<sup>14</sup> Notice under section 7B(9)(c) of the Gas Act 1986 of the grant of five new additional gas transporter licences. This document is available on the Gas Distribution Network Sale page of Ofgem's website.

targeted structural separation.<sup>15</sup> As described in the Final Impact Assessment, Ofgem worked with NGT to understand the implementation issues that would need to be addressed should legal separation be pursued.<sup>16</sup> In the course of this investigation, it became apparent that pursuing full legal separation of the NTS and the RDNs would be likely to prove problematic. This is because:

- ◆ moving Transco's NTS business into a new legal entity would create two low probability risks that could, were either to materialise, create significant costs to customers. These risks are that:
  - ◆ third party contracts that reference Transco's Network Code might need to be adjusted; and
  - ◆ the wholesale gas market might fragment into a number of individual Network Codes with separate market arrangements in each.
- ◆ moving Transco's RDN business into a new legal entity is likely to create disproportionate costs for NGT associated with debt restructuring.

2.40. The Authority therefore concluded that it would not be appropriate to require legal separation of the RDNs and the NTS as part of the DN sales process.

2.41. Ofgem considers that Transco will require two licences under the proposed new arrangements; one for the NTS and one for the RDNs. These proposals were highlighted within the next steps document, and the proposals within this document have been drafted on this basis.

### ***Next steps consultation***

2.42. On 25 November 2004, Ofgem published its next steps consultation on the licensing process associated with DN sales. This consultation document represented:

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<sup>15</sup> *National Grid Transco, Potential sale of network distribution businesses, Offtake Arrangements Conclusions document on framework*, Ofgem, August 2004.

<sup>16</sup> *National Grid Transco, Potential sale of network distribution businesses, Final Impact Assessment*, Ofgem, November 2004, pp. 72 – 74.

- ◆ a formal consultation (under section 23 of the Gas Act) on proposed changes to separate the price control provisions into each of Transco's six GT licences; and
- ◆ an informal consultation (relating to sections 8AA and 23 of the Gas Act) on proposed structural changes to Transco plc's six GT licences to reflect the arrangements that will need to be put in place in the event of DN sales in order to ensure that customers' interests are protected within a divested industry structure.

2.43. Following consideration of respondents' views to the informal consultation issued in November, and further discussions through DISG meetings, Ofgem has refined its proposals with respect to the structural changes and licence modifications required to implement DN sales. This document explains these proposals and represents the formal consultation, under section 8AA of the Gas Act in respect of the four GT licences which will apply to the four IDNs and under section 23 of the Gas Act in respect of the two GT licences which will apply to the NTS and the RDNs respectively.

2.44. Whilst Ofgem has endeavoured to make the consultation relating to licensing reform in the context of DN sales as wide as possible, through the September document and next steps document, some respondents have raised concerns regarding the process Ofgem has adopted. In particular, some respondents have stated that the timescales involved throughout the process have been very tight. In addition, a number of respondents have stated that due to the volume of information and other consultation documents which have been produced by Ofgem, they have not had sufficient time or resources to respond adequately to the licence consultations. While Ofgem notes respondents' concerns, it has endeavoured to ensure that the consultation process has been in line with best regulatory practice.

2.45. In this respect, Ofgem notes the considerable degree of consultation that has been undertaken on the proposed licence changes. This has included a four week consultation on the September document, a four week consultation on the November 2004 section 23 Notice as well as a four week consultation on the potential section 8AA licence modifications outlined in the next steps document

for NGT and potential purchasers and a six week consultation for all other respondents.

- 2.46. Ofgem has also consulted on the details of the proposed licences through weekly DISG meetings following the release of the next steps document, with amended licence drafting being made available on the Ofgem website.

***DTI position paper regarding the treatment of independent gas networks***

- 2.47. In the next steps document, Ofgem indicated that the Authority had asked the Department of Trade and Industry (DTI) to review Special Condition 18 (Conveyance to Independent Systems) in Transco's original GT licence. Ofgem stated that during the implementation of the Gas Act 1995, the DTI took the view that customers connected to independent systems (i.e. systems which are separate from the main GB gas transportation system) that were supplied with LNG and LPG should not be denied the advantages of competition. As a result, Special Condition 18 is a condition that was included in Transco plc's GT licence, on 1 March 1996, at the DTI's behest.
- 2.48. There are five independent LNG networks in Scotland and four independent LPG networks (in Scotland, Wales and the North of England). All of these networks were independent networks when Special Condition 18 was introduced (i.e. separate from the main GB gas transportation system), and all of these systems except one (Stranraer) remain independent today.
- 2.49. Under the provisions of Special Condition 18, which currently constitute "alternative arrangements" as determined by the DTI for the purposes of Amended Standard Condition 29 (Disposal of Assets), customers connected to independent networks should be charged an average price for conveyance which is "no more than the average charge for conveyance to premises in Great Britain". In the case of the LPG networks, Transco is required to subsidise the cost of the gas itself, as well as the costs of conveyance.
- 2.50. In its next steps document Ofgem highlighted that the DTI would be issuing a position paper in due course to inform the industry of the way in which it proposes to take the treatment of independent systems forward in the context of

DN sales. The DTI issued its position paper in January 2005. In this paper, the DTI outlined its proposed policy that the existing arrangements for the independent systems should continue, with:

- ◆ consumers connected to independent networks charged an average price for conveyance which is no more than the average charge for conveyance to premises in GB;
- ◆ this average price calculated annually; and
- ◆ a sunset clause to exclude independent networks that have been subsequently connected to the main gas network (e.g. Stranraer).

2.51. The DTI further stated that, should Transco's proposed sale of DNs proceed, the Secretary of State would issue Transco with a Determination (under Amended Standard Condition 29 of Transco's original GT licence) to confirm what "alternative arrangements" are suitable and that this should apply from the proposed disposal by Transco of these independent systems. The DTI also noted that appropriate changes to Transco's licence would be implemented by Ofgem as part of the formal consultation under section 8AA and section 23 of the Gas Act.

2.52. It is noted that the Secretary of State has now issued three Determinations under Amended Standard Condition 29 of Transco's original GT licence. These Determinations are annexed to the Secretary of State's statement of reasons for her decision to consent to Transco's applications under Amended Standard Condition 29 for the disposal of its four relevant DNs to four wholly owned subsidiary companies. Copies of the statement of reasons and the Secretary of State's Determinations can be found on the DTI website.<sup>17</sup>

2.53. The changes that Ofgem proposes as part of this consultation are described in Chapter 3 and in the relevant section of Chapter 4 on Special Condition 18, with references to consequential changes also made in the sections on Amended Standard Condition 9 and Amended Standard Condition 4A.

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<sup>17</sup> See [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

### ***Authority decision with respect to disposal***

- 2.54. On 20 January 2005, the Authority granted its conditional consent to the four applications from Transco plc under Amended Standard Condition 29 of its original GT licence to dispose of four of its DNs to four relevant wholly owned subsidiary companies, the shares in which would subsequently be sold to third party purchasers.
- 2.55. In making its decision, the Authority gave careful consideration, amongst other things (and without limitation), to:
- ◆ the Final Impact Assessment on potential DN sales which was published for consultation in November 2004;
  - ◆ the responses to the Final Impact Assessment; and
  - ◆ direct representations which it had received (in response to consultations undertaken by Ofgem).
- 2.56. In granting its conditional consent, the Authority concluded that the base case analysis presented in the Final Impact Assessment of the potential net benefits to customers of approximately £225 million associated with the proposed DN sales transaction was reasonable and robust. The Authority was satisfied that the interests of customers in terms of competition and security of supply could be protected in the event of a sale.
- 2.57. The Authority also endorsed its previous decisions on the proposed regulatory, commercial and operational arrangements necessary to protect the interests of customers in a divested industry structure, including the continued development of the enduring offtake arrangements for the allocation of NTS exit capacity and NTS exit flexibility. The Authority also agreed that the proposed enduring offtake arrangements are reasonable, proportionate and protect the interests of customers.
- 2.58. In view of the concerns expressed by respondents to the Final Impact Assessment consultation regarding the timetable for the introduction of the proposed enduring offtake arrangements, the Authority agreed that the implementation of the enduring NTS exit capacity and NTS exit flexibility arrangements did not



need to occur prior to the completion of the DN sales transaction. However, whilst the Authority considered that a short delay in the implementation of the enduring offtake arrangements was appropriate, it considered that their introduction should not be delayed beyond September 2005. In particular, the Authority stated that any such delay would be against the interests of customers and would increase the potential for customers to incur costs as a result of inefficient investment or system operation decisions.

- 2.59. As such, in order to achieve a September 2005 implementation of the enduring offtake arrangements, the Authority has imposed certain conditions to the consent granted to Transco and is proposing a licence condition on Transco and the DNs to secure the implementation of these arrangements on a best endeavours basis (as discussed further in Chapter 3 and Chapter 5).
- 2.60. The conditions attached to the Authority's consent regarding the enduring offtake arrangements form part of a wider set of conditions to its consent that the Authority has imposed in order to ensure that appropriate regulatory, commercial and operational arrangements are put in place to protect the interests of customers in a divested industry structure. These conditions will need to be met for the Authority's consent to become fully effective.
- 2.61. The conditions have been imposed over two phases. As part of the first phase there are conditions precedent which are required to be satisfied prior to the proposed hive-down of the four relevant DNs to the four wholly owned subsidiary companies. As part of the second phase there are conditions subsequent to the hive-down. These conditions will need to be met before Transco can proceed with selling the shares in the four wholly owned subsidiary companies (which will at that stage own the four DN businesses that Transco proposes to sell) to the third party purchasers. These conditions are discussed in detail in the Authority's February 2005 decision document.<sup>18</sup>

### ***Secretary of State's decisions***

- 2.62. On 27 January 2005, the Secretary of State issued her consent to Transco's application to dispose of four of its DNs to four relevant wholly owned

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<sup>18</sup> *National Grid Transco, Sale of gas distribution networks: Transco plc applications to dispose of four gas*

subsidiary companies under Amended Standard Condition 29 of Transco's original GT licence.<sup>19</sup> This followed the Authority's decision to grant conditional consent to Transco on 20 January 2005.

- 2.63. The DTI indicated that it had been working closely with Ofgem, and that the Health and Safety Executive had been working on the safety aspects of the proposed transaction.
- 2.64. In its statement, the DTI indicated that the proposed sale would bring the structure of the gas industry more in line with the electricity sector, allowing Ofgem to perform "comparative regulation" when comparing the performance of different DNs in setting price controls.
- 2.65. The DTI has now released a document setting out the reasons for the Secretary of State's decision. This document can be found on the DTI's website.<sup>20</sup>

### ***Direction to modify – implementation of section 23 changes***

- 2.66. On 25 November 2004, as part of the next steps document, the Authority issued a notice pursuant to section 23(3) of the Gas Act. This notice sought to consult on the Authority's proposal to separate the price controls (as set out in the original Transco licence) to achieve revenue separation between the NTS and each of the IDNs and RDNs.
- 2.67. On 31 January 2005, Transco provided its written consent to the making of these section 23 modifications to each of its six GT licences.
- 2.68. On 1 February 2005, the Authority issued a direction to modify the price control conditions in each of Transco's six GT licences, in connection with the proposed DN sales transaction and in response to the notice issued.
- 2.69. The price control conditions that have been modified relate to areas such as revenue restriction definitions and related provisions, allocation of revenues and

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*distribution networks, Authority decision, Ofgem, February 2005, 21/05.*

<sup>19</sup> Source: DTI press release dated 27 January 2005, available at the following website - <http://www.gnn.gov.uk/environment/dti/>

<sup>20</sup> See [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

costs, information provision in connection with revenue restrictions, the licensee's methodology for determining incremental entry capacity volumes, performance reporting, incentive schemes and output measures for price controls. As a result of the modifications, four of the new additional GT licences relate only to the four DNs to be sold; one of the new additional licences relates only to the four DNs to be retained by Transco, and the original GT licence relates only to the NTS.

- 2.70. Whilst in accordance with the requirements of section 23, only Transco's consent was required as it was the holder of the relevant licences, Ofgem also sought comments on the proposed modifications from, amongst others, potential DN purchasers and other interested parties.
- 2.71. Further changes to the conditions described above (and others) are consulted upon in this consultation document.

### ***Incentives consultation***

- 2.72. The Final Impact Assessment reiterated the Authority's view that the "Option 2" model for offtake arrangements would require the design of both NTS and DN incentive schemes, to support both the "enduring" arrangements (i.e. from 1 October 2008 onwards), and the "interim" arrangements (i.e. from "day one" (currently planned to be 1 May 2005) up to 30 September 2008)<sup>21</sup>. These incentive schemes will, among other things, need to ensure that the NTS has appropriate incentives to release the maximum capability on its network (in response to demand signals) and to ensure that the DNs book an efficient level of NTS exit capacity and NTS exit flow flexibility.
- 2.73. In February 2005, Ofgem published an Initial Thoughts consultation document on the scope, form and duration of the enduring incentive schemes that will apply to both the NTS and the DNs, in the event that DN sales proceed.<sup>22</sup> Following consideration of respondents' views to this document, Ofgem intends to publish initial proposals for these incentive schemes (including both proposed

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<sup>21</sup> *National Grid Transco – Potential sale of gas distribution network businesses, Final Impact Assessment*, Ofgem, November 2004, Page 67

<sup>22</sup> *National Grid Transco – Potential sale of gas distribution network businesses – Initial thoughts on enduring incentive schemes supporting the offtake arrangements*, Ofgem, February 2005.

incentive parameters, and initial drafting of the licence changes necessary to implement the proposed incentive schemes) in Spring 2005.

- 2.74. Ofgem envisages publishing final proposals on incentive schemes supporting the enduring offtake arrangements in July 2005 following consideration of respondents' views to the Initial Proposals consultation. This document will include a formal consultation under section 23 of the Gas Act on proposed licence modifications necessary to implement these proposals, allowing the enduring incentive schemes to be implemented by September 2005.
- 2.75. In addition, Ofgem is planning to issue a consultation document in March 2005, outlining its initial proposals on the incentive schemes to support the interim offtake arrangements, which will apply from 1 May 2005 to 30 September 2008.

### ***Involvement of industry workgroups***

- 2.76. As described in the next steps document, prior to publication of this document, a number of discussions took place through DISG meetings, which considered Ofgem's proposals for changes to Transco's six GT licences in detail, with a particular focus on a number of key issues<sup>23</sup>. It is noted that attendance of DISG meetings has been open to all interested parties.
- 2.77. In recent months, following the publication of the next steps document, the focus of discussions in the DISG meetings on the licensing regime has continued. Indeed, licensing issues have been on the agenda at the majority of DISG meetings since the release of the September document.
- 2.78. In particular, DISG 29 (held on 7 December 2004) was devoted to a review of Ofgem's proposals as part of the informal section 8AA and section 23 consultation within the next steps document. This session helped interested parties to understand Ofgem's proposed position on the broad range of licensing issues. In addition, Ofgem was able to obtain preliminary feedback in relation to the proposed treatment of each of Transco's existing licence conditions. Minutes of this meeting are provided in Appendix 2.

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<sup>23</sup> DISG meetings have been attended by, amongst others, representatives of Ofgem, NGT, potential purchasers, and shippers.

2.79. More recently, DISG members have provided comments on Transco's initial drafting of specific proposed licence conditions. In the period since 7 December 2004 (DISG 29), the group has discussed a variety of key licence conditions, including a review of licence drafting for the following:

- ◆ DISG 30: business separation conditions and price control conditions;
- ◆ DISG 31: LNG Storage provisions, the switch on/switch off condition, and the private CLM procedure condition;
- ◆ DISG 32:
  - ◆ the treatment of GT / shipper interactions within the six GT licences;
  - ◆ conduct of transportation business;
  - ◆ licensee's procurement and use of system management services (for NTS and DNs);
  - ◆ charging related conditions;
  - ◆ emergency service conditions;
  - ◆ the network code condition; and
  - ◆ reform of distribution network interruption.
- ◆ DISG 33:
  - ◆ general high-level principles and the proposed treatment of definitions within the licence;
  - ◆ network code and Agency conditions;
  - ◆ long term development statement condition;
  - ◆ proposals for the connections licence condition; and
  - ◆ the treatment of independent systems within the licence.

- ◆ DISG 34: a page turn of the composite draft licence excluding price control conditions and the connections condition; and
- ◆ DISG 35:
  - ◆ consideration of the price control conditions;
  - ◆ the new connections licence condition;
  - ◆ pipe-line system security standards;
  - ◆ enduring offtake arrangements; and
  - ◆ an overview of recent changes to some of the financial conditions (regulatory accounts, credit rating of the licensee, and indebtedness).

2.80. DISG members have provided feedback both at the DISG meetings and in written form after the meetings. This process has been an important contribution to Ofgem's consultation on the proposed restructuring of Transco's original licence and the five new additional GT licences.

2.81. It should be noted that, whilst some of the detailed comments provided by DISG members are reflected in the appropriate sections of this document, this is not intended to exhaustively reflect all comments which were received.

### 3. Key issues

3.1. The next steps document set out a number of key issues that would need to be considered with respect to the proposed changes to the licensing regime, designed to protect the interests of customers, in the event that a potential gas distribution network (DN) sale were to proceed. Following consideration of responses to the next steps document, the extensive discussion of issues with interested parties at meetings of the Development and Implementation Steering Group (DISG) and the ongoing publication of revised licence drafting on Ofgem's web site, Ofgem has revised this list of key issues and sets out, in this chapter, its position with respect to these issues.

3.2. In this chapter we therefore:

- ◆ describe each of the items within this revised list of key issues;
- ◆ provide a summary of respondents' views on these issues; and
- ◆ set out Ofgem's proposals with respect to each issue, in the light of consideration of respondents' comments to date.

3.3. The key issues considered within this chapter are as follows:

- ◆ **structure of licences**, including new conditions proposed in relation to the private collective licence modification (CLM) and switch on/switch off provisions;
- ◆ **governance**, including provisions relating to transportation charging and the Network Code/Uniform Network Code (UNC);
- ◆ **system security**, including provisions relating to emergency services coordination and pipeline security standards;
- ◆ **price controls** and incentive arrangements;
- ◆ **financial reporting**, including changes required as a result of the distribution price control review to ensure consistency across network licences;

- ◆ **system operator managed service arrangements (SOMSAs);**
- ◆ **standards of performance** (including proposal for connections);
- ◆ **business separation** between both monopoly and competitive businesses; and between Transco's transmission and distribution businesses;
- ◆ **independent systems** following publication of the DTI's position paper on these issues; and
- ◆ **conditions to consent** following the Authority's direction to allow conditionally allow Transco to dispose of some of its DN assets.

3.4. The remaining sections of this chapter consider each of these issues in turn.

### ***Structure of licences***

3.5. In this section, we consider key issues that relate to the structure of the six relevant GT licences proposed to protect the interests of customers in the event of DN sales. The key issues fall under two main headings:

- ◆ the private CLM procedure; and
- ◆ the switch on/switch off provisions.

3.6. These are considered in turn below.

### ***Private CLM procedure***

#### **Next steps document**

3.7. In order to ensure that the interests of customers are protected in the event of DN Sales, it will be necessary to carry out a full scale restructuring of Transco's six GT licences, and to separate obligations relating to:

- ◆ transmission and distribution collectively;
- ◆ transmission only;
- ◆ distribution only; and



- ◆ individual National Transmission System (NTS) or DN-GT licensees.

- 3.8. As a result of this restructuring, along with other modifications to Transco's six GT licences required to ensure that customers' interests are protected in a divested industry structure, many of the current standard conditions would become amended standard conditions. The statutory CLM procedure (as provided for in sections 23(1)(b) and 23(7) of the Gas Act) would then cease to apply to the standard conditions to the extent that they had been modified. Given the scale of the modifications envisaged, Ofgem considered that this would make the statutory CLM procedure largely unavailable for securing changes to NTS and DN-GT licences at a time when it would appear appropriate to have such a procedure in place. As the NTS and DN-GT licences would not all be under common ownership following completion of any DN sale, Ofgem considered that it would be important, in order to protect the interests of customers, to have a mechanism to ensure that collective licence modification would remain a possibility under any divested industry structure.
- 3.9. In the next steps document Ofgem stated that it would be appropriate to restructure the special conditions of the NTS and DN-GTs licences and to introduce a "private" CLM procedure so that there is a mechanism to consistently modify licences in a divested industry structure. Overall, Ofgem considered that the licence structure proposed as part of this consultation would safeguard the interests of customers and was of the opinion that this structure would be robust to any future changes in industry structure, for example, if NGT were to dispose of any further DNs.
- 3.10. Although Ofgem noted concerns expressed by two respondents to the September document, regarding the potential legality of the private CLM procedure, following analysis of these issues, Ofgem remained of the view that the introduction of the private CLM procedure would be appropriate.

### **Respondents' views**

#### *NGT*

- 3.11. NGT raised a detailed drafting point in response to the proposals put forward relating to the private CLM within the next steps document. This is considered in Chapter 5 of this document.

### *Potential Purchasers*

- 3.12. The consortium comprising Scottish and Southern Energy plc, Borealis Infrastructure Management inc and the Ontario Teachers Pension Plan (SSE) supported the inclusion of the private CLM procedure and the replication of the statutory process, in respect of voting thresholds as proposed by Ofgem, but considered that there may be a need to clarify further the interactions between the private CLM condition and the switch on/switch off condition (discussed below). In particular, SSE asked whether a new standard special licence condition, introduced pursuant to the private CLM procedure, would be activated by the private CLM process or whether the activation of the condition would require the operation of the switch on/switch off condition.
- 3.13. Macquarie European Infrastructure Fund (Macquarie) and the consortium led by Cheung Kong Infrastructure Services Limited and including United Utilities (CKI/UU) raised concerns with the proposed voting thresholds. In particular both Macquarie and CKI/UU were concerned that Transco and SSE could veto any proposals and hence considered the arrangements discriminatory. More detail on their concerns is set out in Chapter 5 in relation to the discussion on Standard Special Conditions A2, B2 and D2.
- 3.14. One potential purchaser questioned whether inclusion of the private CLM procedure and switch on/switch off conditions within the NTS licence was an indication of the possibility that the NTS could be fragmented into more than one licensee.
- 3.15. Additional comments on the detailed drafting of this condition are also discussed in Chapter 5 in relation to the discussion on Standard Special Conditions A2, B2 and D2.

### *Shippers/suppliers*

- 3.16. One shipper/supplier was concerned about the complexity of the proposed arrangements for restructuring Transco's six GT licences. This respondent suggested that Ofgem's proposed approach would result in the future licence change process becoming unnecessarily costly and bureaucratic compared to the current arrangements.

3.17. Four shippers/suppliers questioned the legality of introducing the proposed private CLM procedure without reference to normal statutory procedures. These respondents referred to the legal view obtained by the Gas Forum in relation to this proposal. The conclusions contained within this advice were that it would be most appropriate to alter the definition of the activities that require a licence under the Gas Act by means of a statutory instrument made by the Secretary of State under section 41C of the Gas Act. This legal advice set out that as Transco's disposal of four DNs would be an independent restructuring it was unlikely that Parliament would have had these types of transactions in mind when considering a possible enactment of the section 41C process. These respondents considered that:

- ◆ it would be inappropriate for licence arrangements to attempt to mimic primary legislation;
- ◆ the introduction of the private CLM procedure would be an undesirable precedent for the integrity of the licence modification procedure under the Gas Act; and
- ◆ the introduction of the private CLM procedure could set a precedent for similar "self modification powers" to be applied to other licensed activities (for example electricity generation or distribution). The respondent that expressed this view noted that Ofgem had stated that it would not be possible to introduce provisions that would give effect to such "self modification" within GT licences without first obtaining the consent of the licensee. However, the respondent was of the opinion that it could be possible for Ofgem to cite the existence of the private CLM procedure within the NTS and DN-GT licences as a precedent to justify the implementation of future, potentially controversial, changes.

3.18. These respondents requested that Ofgem explain how it has the powers to introduce the private CLM condition. One respondent considered that this issue could significantly impact the indicative timelines published in relation to NGT's potential sale of its DNs.

3.19. One shipper/supplier requested further clarification regarding the way in which this condition would operate, specifically, how the NGT licences would be

treated under this condition, i.e. whether they will be treated as having one or two “votes”, as they will be impacted by changes to this section both as the NTS and a DN licence holder. This respondent questioned whether SSE would also be treated as holding two DN licences. This respondent considered that if this were the case there would be six relevant licence holders, but only two owners who could effectively object under the private CLM procedure, as the other two owners could not alone reach the required 20% of licence holders, making the second stage market share test redundant.

#### *DISG comments*

- 3.20. The licence condition drafting for proposed Standard Special Conditions A2, B2, and D2 have been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 31 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

#### **Ofgem’s proposals**

- 3.21. Ofgem continues to consider that in order to protect the interests of customers it is appropriate to restructure the NTS and DN-GT licences and to introduce the private CLM procedure. The scale of the necessary changes to the NTS and DN-GT licence conditions required as a result of a divested industry structure would substantially restrict the effectiveness of the statutory CLM procedure in respect of the NTS and DN-GT licences. Therefore, in order to ensure that the flexibility afforded by such arrangements continues, it is necessary to introduce the private CLM procedure.
- 3.22. Ofgem notes that the points raised by respondents regarding (in their view) the legality of the introduction of the private CLM procedure were also raised in response to the September document. As stated in the September document, Ofgem has analysed the concerns raised by respondents and is satisfied that the proposals have been developed within the limitations of the current statutory framework and in compliance with the Authority’s statutory and common law duties.

- 3.23. Ofgem does not agree that the implementation of the private CLM questions the integrity of the statutory CLM procedure, as the statutory CLM procedure will still be used in respect of the standard licence conditions. The private CLM procedure will be used where the statutory CLM procedure is not available. The private CLM procedure will be an important regulatory tool to protect customers against inefficient and inconsistent fragmentation and divergence of licence conditions.
- 3.24. In respect of the concern raised that the introduction of the private CLM procedure into the licences of NTS and DN-GTs could set a precedent for the introduction of similar procedures into the licences of other classes of licensees, Ofgem considers that the circumstances in which it is introducing these conditions are exceptional. Furthermore, given the structure of all other industry sectors which Ofgem regulates, such exceptional circumstances are very unlikely to be replicated elsewhere. Indeed, even in such unlikely and exceptional circumstances the consent of the licensees in question would be required.
- 3.25. Ofgem also does not agree with the view that the private CLM procedure and associated restructuring of the GT licence will result in changes to the licences becoming increasingly bureaucratic and costly. Rather, the private CLM procedure proposals have, conversely, been put forward to ensure that the relatively efficient and flexible mechanism for securing licence modifications offered by the statutory CLM procedure can continue (although adapted as required pursuant to a divested gas industry structure) and that the inflexibility and cost that would be caused if each licence holder was required to consent individually to each licence modifications is avoided.
- 3.26. Ofgem has given full and careful consideration to the responses raised regarding the voting threshold requirements proposed in respect of the operation of the private CLM procedure.
- 3.27. Ofgem recognises that keeping the threshold requirements for voting in line with the statutory CLM procedure will have the effect of enabling two gas network businesses individually to block modifications proposed through the private CLM procedure. This is because if the sale of Transco's DNs proceeds in line with current plans, both Transco and SSE will have two votes (as they will both have

two licences) and therefore will have the required percentage of votes to be able to block modifications (20%).

- 3.28. Ofgem has given consideration to the points raised by Macquarie, CKI/UU and one shipper/supplier regarding the potential adverse effects of this position and the proposal to change the threshold requirements to 10% rather than 20%. However, Ofgem continues to consider that it would be inappropriate to change the threshold requirements from those set out in the statutory CLM procedure. The thresholds that were put in place for the statutory CLM procedure were the subject of consultation, although Ofgem agrees with the respondent who stated that a divested gas industry was not considered as part of these proposals. For the avoidance of doubt, the private CLM procedure is not being introduced to address potential shortcomings in the workings of the threshold requirements of the statutory CLM procedure. Ofgem therefore, considers that it is inappropriate to seek to address issues relating to the statutory CLM procedure as part of DN sales. If the DTI were to consult upon, and ultimately change, the statutory CLM procedure, Ofgem would consult upon corresponding changes to the private CLM procedure.
- 3.29. Ofgem therefore continues to consider it appropriate to align the threshold requirements for voting within the private CLM procedure with the statutory CLM procedure and do not consider these arrangements to be unduly discriminatory.
- 3.30. In relation to the points made regarding whether the proposed licence structure is appropriate for the NTS, Ofgem recognises that there is only one NTS at the moment, but that, under the current legislative framework, the possibility exists for more than one NTS. This legal position has therefore been retained in the drafting of the licence. A separate, and important, question would be whether such a development would be economic and efficient and therefore protect the interests of customers.
- 3.31. Ofgem sets out its proposals for the detailed drafting of the private CLM procedure in Chapter 5 of this document. The proposed licence conditions relating to the private CLM procedure (**Standard Special Condition A2: Private Collective Licence Modification Procedure** in respect of Standard Special Conditions applicable to both NTS and DN licensees; **Standard Special**

**Condition B2:** Private Collective Licence Modification Procedure in respect of Standard Special Conditions applicable to NTS licensees; and **Standard Special**

**Condition D2:** Private Collective Licence Modification Procedure in respect of Standard Special Conditions applicable to DN licensees) are provided in Appendices 8A, 8B, and 8D.

### ***Switch on/switch off***

#### **Next steps document**

3.32. In the next steps document, Ofgem proposed other structural changes to Transco's six GT licences in order to ensure that the private CLM procedure was effective. These included:

- ◆ the reversion of amended standard conditions and certain special conditions in Transco's six GT licences to designated standard conditions (as modified by the statutory CLM procedure) and any consequential removal of redundant conditions;
- ◆ the repetition of the relevant standard condition with necessary amendments to create a new standard special condition. These standard special conditions will be subject to the private CLM procedure;
- ◆ the "switching off" of those standard conditions that have been replaced by standard special conditions as part of the process for modifying Transco's licences or are not required; and
- ◆ the introduction of a new standard special condition allowing the conditions in sections A and B of the standard conditions within Transco's six GT licences to be switched on or off, as well as allowing any standard special conditions to be switched off. This switch would be capable of being used in relation to entire conditions, or parts of conditions, and would not be time or frequency limited, enabling it to be used in the future.

3.33. In the next steps document, Ofgem stated that the main circumstance in which there would be a requirement for the Authority to be able to switch off standard conditions would be when it became necessary to modify an existing standard

condition, and therefore create a new standard special condition and switch off the original standard condition. However, Ofgem set out that the switch on/switch off provisions could not have an explicit linkage between the switch on of standard special conditions and switch off of standard conditions as, in certain circumstances, it would be necessary to switch off all or part of a standard condition without there being an explicit replacement by a standard special condition.

- 3.34. Ofgem stated that the switch on/switch off conditions should be standard special conditions based upon the existing Standard Condition 2 in Transco's six GT licences, which would require the explicit consent of the licensee to the switching on or off of a particular standard condition or standard special condition. Ofgem considered that it would not be appropriate for this to be a standard special condition solely applicable to both NTS and DN-GTs (i.e. in Part A of the licence) as it may be the case that a standard condition would remain relevant to NTS-GTs but not DN-GTs or vice versa. As such, Ofgem proposed that this should be a standard special condition applicable to NTS and DN-GTs combined, as well as a standard special condition for the NTS and a standard special condition for DNs.

### **Respondents' views**

#### *NGT*

- 3.35. NGT did not comment on this condition in its response to the next steps document.

#### *Potential Purchasers*

- 3.36. One potential purchaser supported the drafting proposed in the various new conditions published as part of Appendix 7B of the next steps document.
- 3.37. Another requested clarification as to whether the drafting of this condition could affect the working of the proposed new private CLM procedure, as under the draft condition published in the next steps document, the licensee would be required to give consent to switch on any new conditions introduced through the private CLM procedure. The purchaser stated that this would negate the effectiveness of the private CLM procedure.



3.38. Another potential purchaser noted that Ofgem had drafted a switch on/switch off provision for those conditions that apply to the NTS and DN-GTs and those which apply just to the DNs. However, this potential purchaser set out that both those conditions state that, in the absence of a direction for switching on the relevant standard special conditions, the standard conditions in sections A and B have to be complied with, which in turn creates the potential for conflict. This is because if the standard special conditions which apply to the NTS and DN-GTs are switched on, but those which apply just to the DNs are not, the DNs would have one condition stating that the standard conditions in sections A and B did not have to be complied with and another stating, to the contrary, that they do have to be complied with. This potential purchaser suggested that whilst this may not be an issue in practice, if Ofgem were to deal with everything at the same time, it would not be appropriate for such a potential conflict to remain in the licence.

3.39. Further detailed comments on this condition are set out in Chapter 5 in the context of Standard Special Condition A1, B1 and D1.

#### *Shippers/suppliers*

3.40. One shipper/supplier raised a comment regarding the specific drafting of the switch on/switch off condition and the applicability of individual paragraphs within the condition. This comment is set out in detail in Chapter 5 in the context of Standard Special Condition A1, B1 and D1.

#### *DISG comments*

3.41. The licence drafting for Standard Special Conditions A1, B1, and D1 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 31 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

3.42. The point raised by a potential purchaser above, that the requirement for the consent of the licensee to operate the switch could impact on the workings of

the private CLM was discussed at DISG. Ofgem proposed two new versions of the switch on/switch off conditions at subsequent DISG meetings.

- 3.43. At DISG 31 the first version of these conditions was presented, where the requirement for the licensee's consent to operate the "switch" had been removed.
- 3.44. At DISG 34 the second version of these conditions was presented where the requirement for the licensee's consent was reinstated with the exception of circumstances where the "switch" was being used pursuant to a licence modification required as a result of the operation of the private CLM procedure.
- 3.45. Three potential purchasers expressed serious concerns regarding the first version of the conditions presented at DISG which removed the requirement for consent completely.
- 3.46. DISG respondents were, however, generally more supportive of the second version of the licence condition presented at DISG 34 and considered it to be a more reasonable and proportionate proposal. DISG members considered that this version of the licence condition balanced the interests of customers with the rights of the licensee. However, one potential purchaser was concerned that the condition enabled Ofgem to use the switch to introduce "consequential amendments" resulting from the operation of the private CLM procedure without the licensee's consent and considered that this power was too widely drafted.

### **Ofgem's proposals**

- 3.47. Ofgem continues to consider it necessary to introduce a switch on/switch off mechanism for the standard conditions in sections A and B of Transco's six GT licences and the proposed standard special conditions to be applicable to NTS and DN-GTs and the standard special conditions to be applicable to DN-GTs and the standard special conditions to be applicable to the NTS. Ofgem considers that this condition combined with the proposed private CLM procedure will protect the interests of customers.
- 3.48. With respect to the consent requirement within this condition, Ofgem agrees with the respondents who stated that the introduction of the switch on/switch off condition and the private CLM procedure is intended to largely replicate the

current procedures as contained in the statutory CLM procedure. Ofgem therefore, agrees that the consent requirement should be reintroduced.

- 3.49. Ofgem continues however, to have concerns that the consent requirements, as drafted in the conditions published with the next steps document, could frustrate the intention of the private CLM procedure. Ofgem considers that any new conditions introduced through the private CLM procedure should not then need to be switched on, requiring the consent of the licensee. Ofgem has developed its proposals to address these deficiencies in the drafting of the conditions contained in the next steps document as raised by respondents to that document.
- 3.50. In order to largely replicate the workings of the statutory CLM procedure and Standard Condition 2, Ofgem considers it to be appropriate to introduce the consent requirement as set out in the second new version consulted on through DISG 34. As stated above, this consent requirement will not apply in respect of the switching on or off of licence conditions required as a direct result of a licence modification introduced pursuant to the private CLM procedure or in respect of consequential variations.
- 3.51. Ofgem has considered the point raised by a potential purchaser regarding the use of the switch in respect of amendments which are consequential to a modification introduced by the private CLM procedure. Ofgem, however, considers that such a provision would be necessary in certain situations. For example, where a modification is required to a standard condition as designated by the Secretary of State, it may be put forward by way of the introduction of a standard special condition containing the provisions of the standard condition and the necessary modifications. If this new condition is introduced through the private CLM procedure, Ofgem would then need to be able to switch off the standard condition within the licences of the GTs in which the new standard special condition is being introduced. In the future a failure to be able to effect this switch may frustrate the benefits to customers which arise from the introduction of the new standard special condition. As such, Ofgem considers the ability to make consequential variations to be necessary to protect the interests of customers.
- 3.52. Ofgem sets out its proposals for the detailed drafting of the proposed new switch on/switch off conditions in Chapter 5 of this document. The proposed licence

conditions relating to the switch on/switch off mechanism (**Standard Special Condition A1:** Application/Disapplication of standard conditions in section A (Interpretation, Application and Payments) and section B (General) and Application/Disapplication of standard special conditions applicable to both NTS and DN licensees; **Standard Special Condition B1:** Application/Disapplication of standard conditions in section A (Interpretation, Application and Payments) and section B (General) and Application/Disapplication of standard special conditions applicable to NTS licensees; **Standard Special Condition D1:** Application/Disapplication of standard conditions in section A (Interpretation, Application and Payments) and section B (General) and Application/Disapplication of standard special conditions applicable to DN licensees) are provided in Appendices 8A, 8B, and 8D respectively.

- 3.53. **Respondents are invited to comment on the proposed new conditions relating to the structure of the licences.**

## ***Governance***

- 3.54. In this section, we consider key issues that relate to the governance of regulatory, commercial and operational arrangements which would be necessary to protect the interests of customers in the event of any DN sales. The key issues fall under two main headings:

- ◆ transportation charging arrangements; and
- ◆ the Network Code/UNC.

- 3.55. These are considered in turn below.

## ***Transportation charging arrangements***

### **Next steps document**

- 3.56. In the next steps document, in response to concerns raised within the DISG and the views of respondents to the September document, Ofgem considered that:
- ◆ the **Joint Office** should have responsibility for **managing modifications** to the **charging arrangements**, ensuring that the development of charging methodologies is co-ordinated across the industry; and

- ◆ that **NTS and DN-GTs** should be obliged to use **reasonable endeavours** to make changes to charges and the charging methodologies on **two specific dates** each year (i.e. to put in place a **charge change window**).

- 3.57. This was a change from the proposals in the September document which stated that NTS and DN-GTs should be obliged to use reasonable endeavours to make changes to charges on one specific date each year. This change was introduced in response to concerns raised by NGT that the NTS needed to be able to change its charges twice a year (to accommodate the entry capacity auction and commodity charging arrangements).
- 3.58. Ofgem reconsidered the frequency of charge changes in light of the decision taken to adopt an Option 2A approach to offtake arrangements. Ofgem detailed that, under the Option 2A approach, DNs would act as an intermediary for payment flows, and that there would not therefore be any payment flows directly from the NTS to shippers arranging for the conveyance of gas through a DN. As a result, a DN would be required to pass through changes to NTS charges to shippers using its network through corresponding changes in its own charges. Ofgem highlighted that if the NTS were to change its charges on more than an annual basis, this would have implications for the frequency with which a DN would need to change its charges. Ofgem therefore did not believe that it would be appropriate for the obligation upon the NTS-GT to differ to that placed upon DN-GTs.
- 3.59. As such, Ofgem stated that it would revise its proposals so that a reasonable endeavours obligation to change all charges only twice a year on 1 April and 1 October was introduced.
- 3.60. Ofgem also recognised that NGT may receive requests for entry capacity pricing information at new entry points within any charging year. In this regard Ofgem acknowledged that such requests may require additional changes to entry capacity charges, over and above Transco's reasonable endeavours obligation, and detailed that it would review these changes on a case by case basis.
- 3.61. Ofgem noted NGT's proposals for a dead-band within which a standard interest rate would apply, and acknowledged that such a provision would bring the condition into line with National Grid Company's (NGC) electricity transmission licence. Ofgem therefore invited further views in relation to this proposal.

- 3.62. In response to concerns that the initial proposals would not prohibit divergence in charging methodologies raised by respondents, Ofgem considered that in certain situations it might be appropriate to allow divergence in charging methodologies to enable DN owners to be innovative in the operation of their networks. Ofgem acknowledged that there may be costs to shippers and ultimately customers associated with such divergences in charging methodologies and set out that it would take any such costs into consideration when deciding whether to use its right to veto changes to charging methodologies.
- 3.63. With respect to a point raised by one respondent, that the reasonable endeavours obligation would not preclude *per se* a DN-GT licensee from changing its charges more frequently, Ofgem responded that a total restriction would also not be in the interests of customers. However, to fulfil the reasonable endeavours obligation Ofgem stated that it would expect DN owners to provide clear and compelling arguments as to why additional changes were required.

### **Respondents' views**

#### ***Joint Office***

##### *NGT*

- 3.64. NGT supported the proposed role of the Joint Office to administer changes to transportation charges and charging methodologies for the NTS and DN-GTs. Further comments on the establishment of the Joint Office are set out in Chapter 5.

##### *Potential Purchasers*

- 3.65. Two potential purchasers supported the proposed role of the Joint Office with respect to the administration of changes to transportation charges and charging methodologies for the DNs. Further comments on the establishment of the Joint Office are set out in Chapter 5.

##### *Shippers/suppliers*

- 3.66. One shipper/supplier was concerned that the emergence of different DN charging methodologies could increase costs for some consumers, lead to different treatment of similar size customers simply on the basis of network ownership and that this added complexity could limit the number of suppliers willing to compete in particular segments of the market. This shipper/supplier suggested that the transportation charging methodology safeguards did not go far enough. This shipper/supplier considered that it was important to establish licence conditions that subject all DNs to national charging methodologies managed by the Joint Office.
- 3.67. Three shippers/suppliers were concerned that the transportation charging methodologies will diverge, which would have a significant impact on systems, billing and costs. One of these shippers/suppliers advocated a single pricing methodology for all the DNs and suggested that the efficiencies that may be possible by methodologies more cost reflective of each DN are far outweighed by the downside to the operation of the competitive supply market. Another shipper/supplier supported the inclusion of a licence condition upon all DNs that subjects them to management of charging methodology changes by the Joint Office.
- 3.68. Another shipper/supplier suggested that Ofgem should undertake an Impact Assessment before approving any change that deviates from the current Transco charging methodology. This shipper/supplier also proposed extending the minimum 28-day consultation period when more complex changes are required. Further comments on the establishment of the Joint Office are set out in Chapter 5 in the context of Standard Special Condition A12.

***Reasonable endeavours obligation***

*NGT*

- 3.69. With regard to the frequency of changes to charges for the DNs, NGT considered that it was 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 was subordinate to the best endeavours obligation not to over-recover DN-GT licensees' maximum allowed revenue.

- 3.70. With regard to the frequency of changes to charges for the NTS, NGT argued that the NTS should not be restricted to twice per annum changes or changes on specified dates. NGT suggested that 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.
- 3.71. NGT noted Ofgem's initial view but remained of the opinion that it was unnecessary to place the same restriction on non-administered prices such as auction reserve prices. NGT explained that the Network Code clearly sets out auction and reserve price timings and processes and suggested there was the potential for timing mismatch and less efficient reserve price setting if reserve prices are included in this provision. NGT considered that if reserve prices were to be included in the reasonable endeavours obligation then a transitional arrangement would be required in order to enable NGT to introduce exit reserve prices after hive-down for the first auction in September 2005.
- 3.72. NGT explained that NTS transportation constrained LNG credits are currently changed on 1 May, which is timed to allow for commercial decision-making processes and the physical liquefaction process. NGT suggested that the ability to make a 1 May change be retained as long as the constrained credits continue.
- 3.73. NGT suggested that restricting the number of changes in charges will increase the likelihood of the NTS under or over recovering its regulated income by limiting its ability to manage the process. NGT therefore continued to consider that it was appropriate to introduce a dead-band around the allowed revenue level for the NTS licence, to which a standard interest rate would apply, of 5% for NTS System Operator (SO) and 2% for the NTS Transportation Owner (TO). Further detailed comments discussing transportation charges and charging methodologies are set out in Chapter 4 in the subsections on Amended Standard Conditions 4 and 4A.

#### *Potential Purchasers*

- 3.74. With regard to the frequency of changes to charges and charging methodologies for the NTS and DNs, one potential purchaser considered that twice a year would be appropriate. Another potential purchaser highlighted that no



restrictions apply in relation to frequency of modifying electricity distribution charges and suggested that there is no evidence that this has created problems for operation of the market.

- 3.75. All three potential purchasers supported the proposal to introduce a dead-band within which a standard interest rate would apply. One of these potential purchasers suggested that the proposed dead-bands appear to be a reasonable risk mitigation device if charges cannot be changed more than twice a year. Another potential purchaser suggested that this would be in line with NGC's electricity transmission licence and also reflect the electricity distribution network arrangements. This potential purchaser suggested that a 2% dead-band would be appropriate to apply to both the NTS and the DNs. The other potential purchaser agreed with Transco's suggestion of a 2% limit in relation to DN licensees. Further comments discussing transportation charges and charging methodologies are set out in Chapter 4 in the subsections on Amended Standard Conditions 4 and 4A.

#### *Shippers/suppliers*

- 3.76. With regard to the frequency of changes to charges and charging methodologies for the NTS and DNs, four shippers/suppliers supported only allowing changes once a year (aligned to annual contracting rounds). One shipper/supplier recognised that volatility in charging levels between annual charging years is to some extent unavoidable but suggested instability and unpredictability within the charging year is a key issue for shippers, suppliers and customers and remains an impediment to more effective supply competition. One of these shippers/suppliers considered that the current 150 day notice period should continue to remain in place.
- 3.77. Two further shippers/suppliers were supportive of the proposal for two fixed points (in April and October) for introducing revisions and considered that all relevant transporters should work to this timeline to minimise complexity to users and consumers alike. One of these respondents welcomed Ofgem's recognition that any deviation from a generic approach would need to be subject to a cost benefit analysis which would consider the cost implications of such variation on shippers and suppliers. The other respondent suggested that if changes are required outside the specified parameters, the GTs should be

obliged to consult affected parties on the proposed changes, advise on the consequences of not making the proposed changes and secure Authority approval for the deviation.

- 3.78. Two shippers supported the inclusion of a dead-band if this will prevent more frequent and uncoordinated charge changes being implemented by DN-GTs. Further comments discussing transportation charges and charging methodologies are set out in Chapter 4 in the subsections on Amended Standard Conditions 4 and 4A.

*DISG comments*

- 3.79. The licence condition drafting with respect to the reasonable endeavours charge change obligation has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 3.80. Following further development of Option 2A for offtake arrangements, Ofgem reconsidered its position relating to the charge change window and consulted on a new version of the related licence conditions at DISG. Ofgem proposed that to accommodate an Option 2A approach, charge and charging methodology changes on the NTS should only be permitted twice a year, and that charge changes regarding NTS exit capacity and NTS exit flow flexibility (which Ofgem considered would be passed through the DN to shippers from the NTS-GT) would only be permitted once per year. Given that Ofgem did not anticipate that NTS commodity charges would be passed through DNs to shippers from the NTS, it was then proposed that DN-GTs would be obliged to use reasonable endeavours only to make changes to their charges (and charging methodologies) once a year. A number of other changes were also made to the detailed drafting of the condition. These are set out in full in Chapter 4 of this document in the subsections setting Ofgem's proposals for Amended Standard Condition 4 and 4A.
- 3.81. Ofgem stated at the DISG meeting that a number of assumptions had been made in reaching a decision regarding the licence drafting of provisions relating to the

charge change window and that if, as a result of Transco's forthcoming pricing consultation, the NTS were to recover its commodity charges through DNs it would be necessary for Ofgem to revise the relevant licence drafting.

- 3.82. The conditions presented to DISG also included provision for GTs to promote transparency in relation to licensee's compliance with the reasonable endeavours obligation such that the licensee needed to provide the Authority with information relating to changes made outside of the change charge window and reasons for the need to make such a change. There was also provision for the publication of this information by the Authority. These changes were made in response to comments raised by shippers/suppliers to the next steps document and comments raised in DISG meetings.
- 3.83. One potential purchaser noted that the proposed drafting of the condition was based on the assumption that the NTS TO and/or SO commodity charge would not be levied on DNs and, should this be otherwise, the restriction on charger changes would need to be reconsidered. However, they believed, that even in respect of NTS exit capacity and NTS exit flow flexibility, the reasonable endeavours obligation was incompatible with the auction regime proposed as this introduces a revenue recovery issue for the DNs.
- 3.84. The same potential purchaser also pointed out that the proposed condition includes a reasonable endeavours obligation to give 150 days notice of a proposed charge change. This potential purchaser noted that the equivalent notice period for electricity DNOs was reduced to three months notice in July 2004. They stated that they considered it to be appropriate to align the gas DN notice period with the electricity DNO notice period. This potential purchaser was particularly concerned that the combination of the once a year restriction with the 150 day notice period would mean that the potential purchasers of the DN networks would not be able to change their charges until October 2006 which they considered to be inappropriate.

## **Ofgem's proposals**

### ***Joint Office***

- 3.85. Following consideration of respondents' views Ofgem continues to consider it to be appropriate for the Joint Office to take on an administrative co-ordination role

in respect of the relevant GTs' charging methodologies. Ofgem considers that these proposals represent the correct balance between consistency and stability for shippers and allowing the relevant GTs to innovate in the methods they use for transportation charging. Overall, Ofgem considers that its proposals seek to protect the interests of customers.

- 3.86. Ofgem continues to consider that it is not appropriate to go further than this and to require DNs to have common charging methodologies as this could unduly limit innovation by DN-GTs. However, Ofgem does recognise that divergent methodologies would be a significant issue for shippers and that any such divergence could result in increased costs for shippers and therefore, ultimately customers. Ofgem therefore considers that before allowing any such divergence there would be a need to carry out an impact assessment to ensure that the interests of customers are protected.

***Reasonable endeavours obligation***

- 3.87. Following consideration of the views of respondents to the next steps document and subsequent discussions at DISG, Ofgem continues to consider that it is appropriate to introduce a reasonable endeavours obligation on NTS and DN-GTs to limit changes to transportation charges, and the charging methodologies. However, Ofgem has revised its proposals which are as follows:

- ◆ the **NTS GT** to use **reasonable endeavours** to make changes to charges for **exit flow flexibility** and **exit capacity once per year** (on 1 October);
- ◆ the **NTS GT** to use **reasonable endeavours** to make changes to all other transportation charges and its charging methodology **twice a year** (on 1 October and 1 April); and
- ◆ **DN-GTs** to use **reasonable endeavours** to make changes to transportation charges (and the charging methodology) **once per year** (on 1 October).

- 3.88. Ofgem continue to consider it to be appropriate for a reasonable endeavours obligation to apply to the NTS as well as the DN-GTs, including auction reserve prices. A reasonable endeavours obligation would give the NTS sufficient flexibility to change its charges for events such as the introduction of a new entry terminal.

- 3.89. Ofgem notes that the reasonable endeavours obligation will be subordinate to the best endeavours obligations within the licence with respect to revenue recovery. Ofgem does however, consider that it is appropriate to ensure that there is transparency regarding the compliance with the reasonable endeavours obligation and therefore that GTs will be required to inform the Authority when they make changes to charges outside of the charge change window and to provide reasons for the change. The Authority will also publish this information as appropriate.
- 3.90. Ofgem notes the point raised by a potential purchaser regarding the difference between the requirement to use reasonable endeavours to give the Authority 150 days' notice before making changes to its charges and the similar obligation on electricity DNOs which specifies three months. Ofgem also notes the point raised by a potential purchaser that the combination of the charge change obligation and the 150 days' notice period could result in the new DN owners being unable to change their charges until October 2006.
- 3.91. This proposed 150 day notice period is the same as that which is in place in respect of Transco's original GT licence at this time. Ofgem does not consider it appropriate to change this notice requirement as a result of the DN sales process. Ofgem considers that there is protection offered to the NTS and DN-GTs in that the licensees are only required to use reasonable endeavours to give this notice and to make changes to charges on the specified dates.
- 3.92. In respect of the proposal put forward by NGT and supported by the potential purchasers and some shippers/suppliers regarding the dead-band, Ofgem will be considering, as part of the next price control review, the extent to which the arrangements in gas and those in electricity should be aligned. As there is currently a dead-band in place in electricity it is expected that there will be consideration of the application of a similar dead-band in gas at that time. However, Ofgem recognises that the introduction of a dead-band to apply to NTS and DN-GTs is not without cost to customers. On balance we therefore consider that it is not appropriate to introduce a dead-band to deal with issues related to DN sales at this time. If a dead-band is needed we consider that this should rightly be introduced at the time of the price control reviews when all other aspects of the price control are also being considered.

### *Related consultations*

- 3.93. As a result of Transco's forthcoming pricing consultation, Ofgem has made assumptions on which NTS charges will be levied directly on shippers and which will be levied on DN owners and then passed through to shippers. For the purposes of drafting this licence condition Ofgem has assumed that NTS exit flow flexibility and NTS exit capacity charges will be levied on DN owners and that all other NTS charges will be levied directly onto shippers.
- 3.94. However, if the results of Transco's consultation on transportation charges result in different arrangements, Ofgem will need to consult on the modifications to this condition at the further section 23 Notice stage in May 2005.
- 3.95. The detailed drafting of the licence conditions related to this key issue is discussed further in Chapters 4 and 5 of this document. The related licence conditions (**Standard Special Condition A4: Charging Gas Shippers– General; Standard Special Condition A5: Obligations as regards charging methodology; Special Condition C7: Charging Obligations and Standard Special Condition D11: Charging Obligations**) are provided in Appendices 8A, 8C and 8D respectively.

## ***Network Code and offtake arrangements***

### **Next steps document**

- 3.96. In the next steps document Ofgem proposed to require NTS and DN-GTs to introduce a UNC setting out transportation arrangements including offtake arrangements. Each NTS and DN-GT would also have in place a "short form" network code, although it was envisaged that on day one all substantial terms would be set out in the UNC (which would be incorporated into such short form codes (SFC) of each NTS and DN-GT by reference). Ofgem proposed that the procedures for modifying the UNC would be administered by the Joint Office.
- 3.97. Ofgem also proposed that the technical operator to operator arrangements should be contained in separate bilateral agreements, so that unaffected parties could not raise any modifications to these documents. However, all commercial terms should be contained within the UNC.

- 3.98. Ofgem also proposed that the scope of the Agency arrangements would be set out within the UNC and that NTS and DN-GTs would be obliged **not** to opt out of operating through the Agency arrangements.
- 3.99. In addition Ofgem proposed the introduction of two new network code relevant objectives, namely to ensure:
- ◆ licensees establish a network code that among other things facilitates the achievement of the co-ordinated and efficient development of the pipeline systems; and
  - ◆ the promotion of efficiency in the implementation and administration of the network code and/or the UNC.

### **Respondents' views**

#### *NGT*

- 3.100. NGT considered that the scope of the Agency and subcontracted services should not be included in the UNC because the GTs must be able to manage effectively their relationship (and their costs) with the Agency, and shippers should not be able to raise modifications to the Agency services agreement. NGT suggested that allowing shippers to submit modifications (even to the scope of services which could be submitted to the Agency) would create an issue with cost allocation and control because shippers do not own the financial consequences of any changes in the short term that would expand the scope of these services. Longer term, NGT stated that it expected that shippers would own the financial consequences of any scope expansions. Therefore, it was NGT's view that this matter should be addressed at the time of the next price control and, in the intervening time, the scope of the Agency'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.
- 3.101. However, in more recent discussions in DISG, NGT has accepted the need for the scope of the services and systems that will be sub-contracted to the Agency to be set out within the UNC.
- 3.102. NGT supported the concept of the commercial rules that relate to the offtake of gas at all NTS exit points residing in the UNC. NGT also agreed that the more

technical operator-to-operator arrangements should reside in separate agreements between the NTS and the DNs, analogous to the Network Exit Agreements (NExAs) agreements that currently exist between the NTS and other parties connected directly to the NTS with an additional section in the UNC defining the scope of the NTS/DN operator arrangements. More detailed comments can be found in Chapter 4 in relation to Amended Standard Condition 9 and in Chapter 5 in relation to the Agency proposals.

#### *Potential Purchasers*

- 3.103. One potential purchaser supported offtake arrangements being handled in a separate code. This potential purchaser considered that at least the relevant technical aspects should be contained in documents separate to the UNC which cannot be amended by UNC modification proposals.

#### *Shippers/suppliers*

- 3.104. One shipper/supplier considered that the changes to licences requiring transporters to establish the UNC, the new Joint Office Arrangements and to be a party to the new agency arrangements offered the greatest protection against inefficient fragmentation of the arrangements. However, this respondent was concerned as to whether Transco would fully implement the vision for the Joint Office set out most recently in Ofgem's Final Impact Assessment. In addition, this respondent considered it more appropriate to establish a Joint Office which was more constitutionally 'separate' from Transco.
- 3.105. This shipper/supplier supported placing all commercial offtake rules within the UNC, with technical matters being covered consistently in bilateral agreements so that unaffected parties could not raise any modifications to these documents. However, this shipper/supplier proposed that the form of many of these technical exit arrangements should be specified in the UNC, in a similar way that existing network exit provisions are specified in the code but technical parameters are specified in Network Exit Agreements (NExAs) with NTS direct connects. This shipper/supplier suggested that such an approach would ensure that the UNC governs the type, but not the exact values of, technical parameters, thereby helping to ensure consistency wherever appropriate between different types of NTS connectees.



- 3.106. This shipper/supplier also suggested preventing any change to the short form codes (SFC) without reference to the UNC modification rules. This shipper/supplier therefore, considered that it would be appropriate to introduce an obligation to require licensees to ensure that any changes to gas transportation arrangements are subject only to the change procedures set out in the UNC modification rules.
- 3.107. Another shipper/supplier welcomed Ofgem's proposals to put an obligation on Transco and the IDNs to promote efficiency in the implementation and administration of the Network Code.
- 3.108. Two shipper/suppliers preferred a UNC only approach with the modification process managed by the Joint Office to ensure that shippers are able to raise modifications.
- 3.109. One shipper/supplier suggested that it was unclear where separate bilateral agreements for the technical operator to operator arrangements would be contained. This shipper/supplier suggested that there could be some technical issues that could contain commercial information but these agreements would reside outside of the UNC (e.g. ramp rates, maintenance programme). This shipper/supplier also suggested that it was unclear who the bilateral agreements would be between and whether this was referring to an agreement between shippers and Transco or DN and Transco.
- 3.110. One shipper/supplier considered that there should be a UNC since any other governance arrangement would probably increase fragmentation complexity for shippers and hence result in large costs to end-users. This respondent agreed that, in this respect, the Joint Office would provide a useful supporting role to ensure these concerns do not materialise. However, this respondent suggested that significant questions regarding the interaction between the Joint Office, modification panel and modification rules remained and further review including all parties was required. More detailed comments can be found in Chapter 4 in relation to Amended Standard Condition 9 and in Chapter 5 in relation to the Agency and Joint Office proposals.

### *DISG comments*

- 3.111. The licence condition drafting with respect to the Network Code and offtake arrangements has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32, DISG 33, DISG 34 and DISG 35). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 3.112. Many of the changes discussed at these DISG meetings related to the detailed drafting of the licence conditions and are considered in more detail in Chapter 4 in relation to Amended Standard Condition 9 and in Chapter 5 in relation to the Agency and Joint Office proposals. These changes included:
- ◆ significant structural changes to the Network Code condition to clarify the definitions of the UNC and the SFCs;
  - ◆ clarification of which parties will be entitled to propose modifications and alternative modifications to the SFCs and UNC; and
  - ◆ combining the proposed licence conditions relating to Agency and Common Systems Agreements and clarification of where the scope of the systems and services to be delegated to the Agency would be set out.
- 3.113. A number of detailed comments on the drafting were received at the DISG meetings. These are discussed in detail in Chapters 4 in the context of Amended Standard Condition 9 and Chapter 5 in the context of Standard Special Conditions A12 and A15, but generally respondents welcomed the changes that clarified the Network Code condition further. However, some concern was expressed regarding the obligations relating to the alternative modification proposals.

### **Ofgem's proposals**

#### *Offtake arrangements and UNC*

- 3.114. Following consideration of respondents' views, Ofgem continues to consider that it is appropriate for the commercial offtake arrangements to be set out in the

UNC, with technical operator to operator arrangements contained in separate agreements between Transco NTS and the DN-GTs in question. Ofgem considers that these agreements should be capable of modification to the same extent as the current NExAs.

#### *Short form codes*

- 3.115. Each NTS and DN-GT will also be required to have in place a short form network code (SFC). It is the intention that on day one all substantive transportation arrangements will be set out in the over-arching UNC. However, there is flexibility for modifications to be proposed to move provisions from the UNC to the SFC of a NTS or DN-GT if this would better facilitate the relevant objectives of the UNC and the SFC. The modification procedures for the UNC and the individual SFCs will sit within the UNC. However, with the Authority's consent it would be possible for the modification procedures of a SFC to be removed from the UNC and placed into that SFC. More detail can be found in Chapter 4, in the subsection on Amended Standard Condition 9.

#### *Joint Office*

- 3.116. In respect of the points raised regarding the desirability of the independence of the Joint Office, Ofgem considers that it is important for the Joint Office to maintain independence from GTs to ensure the equitable administration of the modification rules of the UNC. The provisions regarding the independence of the Joint Office will be set out in the Joint Governance Agreement which will be consulted upon by Ofgem through DISG. Ofgem considers it to be important for respondents to be able to comment on the independence requirements set out in that agreement. However, Ofgem does not, at this stage, consider it to be appropriate for requirements regarding the independence of the Joint Office to sit within the licence conditions. More detail can be found in Chapter 5 in the subsection on Standard Special Condition A12.

#### *Agency*

- 3.117. Ofgem notes that NGT has accepted the need for the scope of the services and systems that are sub-contracted to the Agency be set out within the UNC. It is Ofgem's view that this offers the best protection for customers in ensuring that there are checks and balances in modifications to the scope of the Agency. The

Agency Agreements themselves will also be consulted on by Ofgem through DISG. More detail can be found in Chapter 5 in the subsection on Standard Special Condition A15.

#### *Related consultations*

- 3.118. Ofgem will be consulting on the UNC in March 2005. This consultation will inform the Authority's decision making on Transco's proposals to modify its current Network Code to create a SFC which incorporates by reference the UNC and whether to direct the licence modifications set out in the section 8AA notice (and associated section 23 Notice) in April 2005.
- 3.119. It is important to note that the proposals set out in this document, and the drafting of the licence conditions have been put forward based on Ofgem's best understanding of the development of the UNC proposals at this time. However, the detail of the UNC, and associated agreements, are not finalised. In addition, Transco has not yet raised its Network Code modification proposed to convert its existing Network Code into its short form network code. As such, given the uncertainty, there is a significant risk that the licence conditions being proposed here may require further modification following finalisation of the UNC and associated agreements. Any such further modifications will be introduced as part of a further section 23 Notice post hive-down.
- 3.120. The detailed drafting of the licence conditions related to the Network Code is discussed in Chapter 4 and in relation to the Joint Office and Agency Chapter 5. The licence conditions: **Standard Special Condition A11**: Network Code and Uniform Network Code; **Standard Special Condition A12**: Joint Office Governance Arrangements and **Standard Special Condition A15**: Agency, are provided in Appendix 8A.
- 3.121. **Respondents are invited to provide comments on the licence drafting issues relating to governance.**

### ***System security***

- 3.122. In this section, we consider key issues that relate to system security in the event that DN sales proceed. The key issues fall under two main headings:

- ◆ emergency services coordination; and
- ◆ pipeline security standards.

3.123. These are considered in turn below.

### ***Emergency services coordination***

3.124. In this section, the following three issues relating to emergency services coordination are considered:

- ◆ emergency provision at DN boundaries;
- ◆ first response emergency services to Independent Gas Transporters (IGTs); and
- ◆ first response emergency services to the NTS.

### **Next steps document**

#### *DN boundaries*

3.125. In the next steps document Ofgem stated that it would be important for arrangements to be in place between DNs regarding the provision of emergency services at DN boundaries. Ofgem detailed that it had been informed, by NGT, that these provisions would be included within the GTs' safety cases, and that arrangements would therefore need to be in place to the satisfaction of the Health and Safety Executive (HSE). For this reason, Ofgem considered that it would be inappropriate to impose a licence obligation of this nature.

#### *First response emergency services to IGTs*

3.126. Transco currently provides emergency services in respect of emergencies on networks belonging to IGTs through a commercial emergency service contract between Transco and the IGTs. In the next steps document, Ofgem gave consideration to the provision of emergency services to IGTs post any DN sales. Ofgem stated that it had considered the responses received to the September document regarding this issue and that it had also carefully considered, consistent with its duties, the aspects of emergency service provision that would

arise as a consequence of the potential fragmentation of Transco's transportation business.

- 3.127. Ofgem noted that the majority of respondents were of the opinion that additional licence conditions in respect of the provision of emergency services to IGTs (either with respect to "make safe" and/or "repair and restoration") would be necessary as part of DN sales.
- 3.128. Ofgem noted that the key difference between the status quo and any divested structure would be that the number of network owners that an IGT may have to interface with would increase. Ofgem stated that, under the status quo, IGTs would continue to have a commercial contract for the provision of these services, which encompass both "make safe" and "repair and restoration".
- 3.129. Ofgem noted that since the September document was issued, NGT had extended the duration of its commercial contract by six months to give the IGTs additional time to negotiate with the new potential purchasers regarding any renewal of the emergency services contract and detailed that, prior to the expiration of the current contract, it would undertake a review of the provision of these services. Ofgem set out that this review would, as requested by some parties, include a full assessment of the extent to which repair and restoration services are contestable activities. Following this review, Ofgem stated that it would propose any GT licence modifications it considered to be necessary to protect the interests of customers.

*First response emergency services to NTS*

- 3.130. Appendix 7B of the next steps document provided licence drafting obliging DNs to provide emergency services to make safe any emergency on the NTS. The next steps document stated (in error) that such services should be provided to the NTS at a reasonable rate, although the actual licence drafting did not include such an obligation.
- 3.131. At DISG 29, Ofgem highlighted this error and emphasised that, because the DN workforce that currently provides this service was already funded within the DN price controls, the DNs should not receive payment for the provision of such services within the current price control.

## **Respondents' views**

### ***DN boundaries***

*NGT*

- 3.132. NGT supported Ofgem's decision not to include a licence condition to cover the provision of emergency services at DN boundaries as it considered that this issue is effectively regulated through the DN gas transporter safety cases governed by the Gas Safety (Management) Regulations 1996 (GS(M)R).

### ***Potential Purchasers***

- 3.133. One potential purchaser agreed that the DN boundary issue should be dealt with through the safety case and not the licence.

### ***Shippers/suppliers***

- 3.134. One shipper/supplier considered that it would seem reasonable to require any DN workforce notified of an incident to respond and, where it was subsequently found not to be on their network, for that party still to undertake to make safe the incident. This shipper/supplier suggested that this could impose additional delays in responding to an incident and have a detrimental impact on the overall safety regime if not implemented.
- 3.135. Another shipper/supplier suggested that if additional licence conditions are not necessary then the DN-GTs' safety cases should be made available to the industry to ensure that these obligations are in place.

### ***First response emergency services to IGTs***

*NGT*

- 3.136. NGT supported Ofgem's proposal not to alter existing licence obligations for first response services to IGTs. Further details can be found in Chapter 4 with regard to the existing Special Condition 19 that sets out Transco's current obligations where a major loss of supply has occurred.

### *Potential Purchasers*

- 3.137. One potential purchaser considered it appropriate to continue for the moment with the present arrangements regarding first response emergency services to IGTs, and for this matter to be reviewed prior to contract expiry. Further details can be found in Chapter 4 with regard to Special Condition 19.

### *Shippers/suppliers*

- 3.138. One shipper/supplier agreed with Ofgem's proposal for the current arrangements relating to emergency services provided by Transco to IGTs to continue. This shipper/supplier and another shipper/supplier welcomed Ofgem's commitment to undertake a full review of such services when the current commercial contract with Transco expires. Another shipper/supplier stated that it did not consider it entirely satisfactory to continue the present arrangements in relation to the first response to IGTs. This shipper/supplier stated that it would be appropriate, if only as part an interim measure to the end of the current price control for there to be a price control condition to oblige the transporter to both "make safe" and carry out "repair and restoration". This shipper/supplier also stated that any consultation on arrangements for first response to IGTs would almost certainly take longer than the six month extension to Transco's current arrangements.
- 3.139. Another shipper/supplier was concerned that an unsatisfactory solution for first response services to IGTs is being proposed. This shipper/supplier suggested that areas that are already open to competition - such as gas pipeline extension, should remain so. This shipper/supplier was concerned that Ofgem's proposals in relation to first response to IGTs could have a negative impact on gas pipe-line extensions such as infills. Further details can be found in Chapter 4 with regard to Special Condition 19.

### ***First response emergency services to NTS***

#### *NGT*

- 3.140. NGT supported Ofgem's initial conclusion favouring a new DN licence obligation requiring DNs to provide a first response emergency service to the NTS. Further detailed comments in relation to Standard Special Condition D6 are set out in Chapter 5.



### *Potential Purchasers*

- 3.141. With regard to the provision of first response emergency services to the NTS, one potential purchaser accepted a licence obligation to provide such a service. However, it stated that it did not believe that the costs of this service were already within its price control. This potential purchaser considered that, if the charging arrangements are appropriately covered in both sets of revenue restrictions, customers would not have to pay twice for this service. This potential purchaser also suggested that these services could be contestable and if such services are a free good to the NTS, then any incident occurring near a DN boundary would see a perverse incentive to use IDN rather than Retained Distribution Network (RDN) staff. Further detailed comments in relation to Standard Special Condition D6 are set out in Chapter 5.

### *DISG comments*

- 3.142. The licence condition drafting with respect to emergency services co-ordination has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants and other industry participants have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

### *DN boundaries*

- 3.143. In relation to issues at DN boundaries a shipper/supplier asked whether a requirement was needed in the licence to ensure that a DN responding to incidents on another DN's network were required to report to the DN on whose network the incident occurred or to the relevant shipper/supplier.

### *First response emergency services to NTS operator*

- 3.144. During DISG 29 a potential purchaser raised a concern that the condition relating to first emergency response to the NTS needs to be clear that the "to act in a best manner" does not require a DN to undertake any physical work on the NTS. This potential purchaser also outlined that it did not believe that the cost of providing this service was included in the price control.

## **Ofgem's proposals**

### *DN boundaries*

- 3.145. Ofgem continues to believe that the safety case is the most appropriate place for arrangements relating to boundary issues to reside. Transco has stated to Ofgem that the safety case covers incidents on DN boundaries. This has been confirmed by the HSE. In relation to respondents' views that there is a need for an obligation to be placed on transporters responding to an incident on a DN boundary to notify the DN whose network the incident is on, Transco stated that this obligation is clearly stated in the safety case. The HSE is satisfied that it has adequate powers to ensure that these matters are covered by the safety case. As such, Ofgem does not believe it is necessary to replicate this arrangement in the licence. Therefore, Ofgem is not proposing any licence modification to address this issue.

### *First response emergency services to IGTs*

- 3.146. Ofgem is committed to reviewing the arrangements regarding the first response emergency services to IGTs and any outcome of such a consultation will have an element of "bedding down" time before the present contract between IGTs and Transco expires. It is presently envisaged that the consultation document will be published in April 2005 with a workshop initially planned for May 2005. It is expected that a next steps document including drafting of a licence condition (if required) will be published in July 2005 with a final proposals document being published in September 2005. By June 2006 it is proposed that any new arrangements would be implemented.
- 3.147. Ofgem is committed to ensuring that competition continues to develop in relation to infills and this will be considered as part of this consultation. However, Ofgem maintains that this is not a DN sales related issue.
- 3.148. Ofgem therefore, proposes not to introduce any new licence conditions but to replicate the existing provisions in Transco's licence that deal with major losses of supply. These proposals are set out in Chapter 4, in the subsection setting out Ofgem's proposals Special Condition 19.

### *First response emergency services to NTS*

- 3.149. Ofgem continues to consider it appropriate for DN-GTs to provide first response emergency services to the NTS.
- 3.150. When Transco accepted the current price control settlement its DN field force would have been required to provide first response service to the NTS and, moreover the efficient level of costs of providing this service would have been included in the allowed operating expenditure of the DN field force. Ofgem therefore continues to maintain that the cost of these services are allowed for in the present price control for DNs and does not consider it appropriate to include a provision in the licence for DNs to recover a reasonable amount for providing these service to the NTS. Ofgem does however believe that the issue of cost recovery for these services will need to be examined at the next price control review.
- 3.151. Ofgem notes respondents' views that the licence condition needs to make clear the type of assistance expected by the NTS. Following consultation with the HSE, Ofgem has amended the wording of this condition so that it is clear that the DN-GT shall not be required to carry out any physical work on the NTS, unless the NTS operator requests or authorises otherwise.
- 3.152. The detailed drafting of the licence condition relating to this key issue is considered in more detail in Chapter 5 of this document in the subsection on discussing Standard Special Condition D6. Furthermore, the drafting of **Standard Special Condition D6** (Provision of First Call Emergency response to the NTS Operator) is provided in Appendix 8D.

### ***Pipeline security standards***

- 3.153. In this section we consider the issues associated with pipeline security standards (which is referred to as the 1 in 20 obligation) that arise on account of Transco's proposed transaction.

#### **Next steps document**

- 3.154. Consistent with Ofgem's decision regarding the offtake arrangements, in the next steps document, Ofgem expressed agreement with the majority of respondents that the 1 in 20 obligation should apply to all GTs including NTS and DN-GTs.

- 3.155. However, Ofgem identified that this condition may require modification of a technical nature to reflect Transco's proposals in relation to the NTS exit flexibility product. Ofgem detailed that, at present, customers directly connected to the NTS are required to purchase a level of maximum daily offtake quantity (MDQ) consistent with their maximum hourly offtake quantity (MHQ), and each customer is not permitted to exceed 1/24<sup>th</sup> of its MDQ in any given hour. Ofgem explained that, under the offtake arrangements, it had been proposed that NTS exit flexibility would be defined as a separate product and that it would be allocated and traded in the same way as firm NTS exit capacity. In this respect, Ofgem stated that this would enable some customers to meet their required level of MHQ through the purchase of NTS exit flexibility, and therefore reduce their purchased level of MDQ.
- 3.156. Ofgem highlighted that this may have technical implications given that Transco's "1 in 20" obligation requires it to design the system to meet "peak aggregate daily demand" and that it may therefore be necessary to modify Standard Condition 16 to reflect Transco's proposals for the NTS exit flexibility product. Ofgem stated that these modifications would make the obligation a standard special condition applicable to all NTS and DN-GTs to deliver the level of MHQ requested by NTS connectees as well as MDQ.
- 3.157. Ofgem outlined that it would seek to ensure that, following any such modification, the revised condition had the same effect as it currently has under Transco's common ownership. As these issues were still under consideration in Transco's exit development forum, Ofgem did not propose any modifications or provide drafting as part of the next steps document, but simply proposed that the provisions should apply to all NTS and DN-GTs. However, Ofgem considered that if such modifications were required later in the process these would be informally consulted upon through the DISG.

### **Respondents' views**

#### *NGT*

- 3.158. NGT suggested that in the case of the NTS, the exit capacity auctions will provide information on the need for exit capacity, backed by firm financial commitments from connected parties. NGT suggested that, inevitably, these

market signals will be supplemented with other information such as knowledge of forthcoming developments that have yet to bid into auctions. NGT considered that if such information were to be ignored, there could be a risk that the system would be developed in a piecemeal and hence inefficient manner and such a development could then be considered to breach their general obligation to develop an efficient system. NGT considered that the 1 in 20 obligation would provide helpful clarity on the extent to which such additional information should be used in developing the network.

3.159. Furthermore, NGT considered 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; and
- ◆ 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.
- ◆ NGT also commented that the definition of the 1 in 20 obligation should be made more flexible specifically relating to the number of years of data over which the obligation is defined. This issue is described in more detail in Chapter 4 (in the context of Standard Condition 16).

#### *Potential Purchasers*

3.160. One potential purchaser considered that the security standard should be applied uniformly, and that technical details need to be consistent. This potential purchaser requested more details of the associated commercial implications.

3.161. Another potential purchaser questioned why the pipeline system security standards licence obligation may need to be changed to reflect the introduction of the proposed NTS exit flexibility product. This potential purchaser suggested that any changes would have HSE implications and changes are outside the remit of the DN sales process.

3.162. Another potential purchaser accepted the requirement for a DN to have a 1 in 20 obligation but considered that there is a fundamental difference in the way that a DN secures its capacity (and flexibility) requirements compared to Transco as an integrated business. This potential purchaser suggested that Transco has entirely physical assets to secure its obligation, whereas a DN cannot meet its obligation with these alone and has to rely on contractual provision from Transco as well. This issue is discussed in more detail in Chapter 4 (in the context of Standard Condition 16).

*Shippers/suppliers*

3.163. Three shippers/suppliers agreed with Ofgem that a licence condition should apply to both the NTS and the DN-GTs for the 1 in 20 obligation as this would ensure that there is a commitment from these parties to develop their networks to meet daily gas demands. However, one of these shippers/suppliers was concerned that Ofgem was proposing to amend one of the standard conditions in order to accommodate the changes being proposed under the offtake arrangements and the NTS exit flexibility product which this shipper/supplier does not support.

3.164. Another shipper/supplier was concerned that the definition of the 1 in 20 obligation for the NTS was being revised to facilitate the introduction of radical changes to the exit arrangements. This shipper/supplier suggested that the wording of any new licence obligation must ensure that the current rights enjoyed by firm NTS direct connects are not diminished under an obligation which involves an unbundled exit capacity product. This issue is discussed in more detail in Chapter 4 (in the context of Standard Condition 16).

*DISG comments*

3.165. At DISG 34 Ofgem proposed to switch off Standard Condition 16 and insert the provisions of this condition into a new standard special condition (Standard Special Condition A9), with paragraph 2 modified appropriately to reflect the NTS exit flow flexibility product. At this meeting, Ofgem suggested the insertion of the words “including, but not limited to, aggregate peak hourly demand”.

3.166. NGT considered that the inclusion of an aggregate peak hour demand standard placed upon gas transporters an uncertain obligation with no corresponding

beneficial effect. NGT had suggested its own drafting that would meet Ofgem's objectives and without triggering a review of obligations.

- 3.167. NGT also considered that Ofgem should question whether it is appropriate to require gas transporters to publish further information such as planning policy procedures particularly as this area of activity is regulated by the HSE.
- 3.168. One potential purchaser stated that while they accepted the provisions in this condition in general, they did not believe that the new insertion to require the planning standard to include aggregate peak hourly demand was workable. In principle, this would require them either to build a network to meet peak hourly demands which, given that this had not been done in the past, was likely to be inefficient, or buy a product to allow them to manage hourly flexibility. However, the product currently proposed by NGT was not an hourly product, but a 16 hour product which allowed this buyer to profile its offtake over the period. If an hourly peak demand condition applied, the buyer expressed the concern that this may move them towards either hourly balancing, or an hourly flex product, neither of which had been the subject of recent consultation.
- 3.169. Another potential purchaser stated that a new requirement had been added into this condition by including reference to aggregate peak hourly demand, which might have significant impact on network design. They therefore wished to understand why this requirement had been introduced. In any event, they did not believe this change was connected to the sale process and hence were of the view that it should be removed from the licence.
- 3.170. Another potential purchaser stated that they did not support the proposed change to paragraph 2 where the words "including, but not limited to, aggregate peak hourly demand," as they believed that this had fundamentally changed the existing security of supply obligation by forcing it from being a daily regime to an hourly regime.
- 3.171. Following further consideration of respondents' views, and further discussions with NGT, the licence drafting for Standard Special Condition A9 (Pipe-Line System Security Standards) was further revised and presented to DISG 35. The words inserted within paragraph 2 were changed from "including peak hourly demand," to "including, but not limited to, within day gas flow variations on that day". This drafting was presented for discussion at DISG 35.

3.172. This wording was agreed to be acceptable by NGT, however, NGT maintained that such words were not necessary.

3.173. The minutes of these DISG meetings are attached in Appendix 2.

### **Ofgem's proposals**

3.174. Ofgem continues to believe that it is necessary to amend the 1 in 20 obligation in order to ensure that it is as effective going forward and to ensure that there is clarity regarding the security standards of the NTS and DN-GTs. The amendments made to this condition involve a small change to ensure that the 1 in 20 obligation is clear that the licensee must take account of within day gas flows variations. This change is not intended to strengthen the security standard, but rather ensures that it is as effective in the future as it has been to date. The HSE has also confirmed to Ofgem that it is content with the change.

3.175. The detailed drafting of this condition is discussed in Chapter 4 of this document in the context of Standard Condition 16. The related licence condition (**Standard Special Condition A9: Pipeline System Security Standards**) is also provided in Appendix 8A.

3.176. **Respondents are invited to comment on the key issues of system security.**

### ***Price controls***

3.177. In this section we set out Ofgem's proposals for price control and incentive arrangements.

### **Next Steps document**

3.178. In the next steps document, Ofgem stated its view that:

- ◆ Transco's current price controls should not be reopened as part of DN sales, but that incentives should be placed upon the NTS and DNs to encourage efficient investment decisions;
- ◆ the initial duration of the new incentive scheme for DNs should be for one year only; and



- ◆ that a “safety net” should be introduced to ensure that customers are protected in the event that only one comparator is created by DN sales and costs exceed benefits.

3.179. Ofgem stated that the proposed incentive arrangements would be supplemental to the price control and that these would be considered in detail in a separate consultation document.

### **Respondents’ views**

#### *NGT*

3.180. NGT expressed its support for Ofgem’s proposal not to reopen Transco’s price controls. However, NGT stated that it did not consider a safety net to be required, consistent with its response to Ofgem’s Final Impact Assessment on DN sales.

#### *Potential Purchasers*

3.181. One potential purchaser agreed that the price controls should not be reopened, that the initial duration of any DN level incentive scheme should be for one year, and that a safety net should be introduced. Another potential purchaser agreed that it will be necessary to adapt the price control conditions to reflect the fact that DNs will be passing through NTS charges to shippers and to reflect Ofgem’s proposal to introduce an incentive regime in relation to the NTS/DN interface.

#### *Shippers/suppliers*

3.182. Two shippers/suppliers also agreed with Ofgem that the current price controls should not be reopened and that appropriate incentives should be placed upon the NTS and DN-GTs to encourage efficient investment decisions. However, one shipper/supplier suggested that while the RPI-X controls are not being touched, introducing new incentives would constitute a re-opening of the price controls. Another shipper/supplier suggested that, whilst there may be arguments for revisiting the current price control, these should be weighed against the additional administration and uncertainty that this would create, and changes should only be made if they can be fully justified. Another shipper/supplier requested assurance that customers and shippers would not be

subject to additional GT charges or higher than expected charging levels if the DN sale proceeds. This respondent also stated that a one year's initial duration for the DN incentive scheme may be insufficient. More detailed comments from shippers/suppliers are set out in Chapter 4 in the subsection on Special Condition 28B.

#### *DISG comments*

- 3.183. The licence condition drafting with respect to the price control conditions has been discussed at a number of DISG meetings since publication of the next steps document, including DISG 30 and DISG 35. Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 3.184. The detailed comments are discussed further in Chapter 4 in the subsection on Special Condition 28B.
- 3.185. NGT expressed opposition to Ofgem proposals to adjust the price control drafting with respect to the summation of DNK terms (the revenue adjustment factor for DN revenue over or under recovery) such that each of the RDNs is treated separately.

#### **Ofgem's proposals**

- 3.186. Ofgem continues to be of the view that the current price controls should not be reopened but that incentives placed upon the NTS and DN-GTs should be "bolted on" to the price control conditions to encourage efficient investment decisions and efficient operational decisions. These incentive arrangements will be part of a separate consultation process as discussed in Chapter 6.
- 3.187. As part of the section 8AA consultation (and associated section 23 consultation), we are proposing minimal changes to the price control conditions, with key changes relating to:
- ◆ inserting new terms into the actual revenue principal formulae for the NTS to reflect the new source of actual revenues;

- ◆ inserting new terms into the maximum DN transportation activity principal formula to reflect the fact that certain charges will be passed through the DNs to shippers by the NTS;
- ◆ amending the DN licences such that DNK terms are no longer summed across the four RDNs before the penal interest rate is applied in the event of over-recovery of revenue. This is consistent with Ofgem's general policy for price control separation of the RDNs;
- ◆ amending the RDN and NTS licences to ensure that, following DN sales, new percentages are applied to allocate the total prescribed rates bill received by Transco to reflect the fact that the bill will relate to fewer businesses. These percentages have been derived to be consistent with the methodology applied by the Valuation Office Agency to establish rates bills for the IDNs; and
- ◆ inclusion of additional terms for the introduction of a customer safety net as discussed further in Chapter 4.

3.188. Further changes to the price control conditions will be required as part of two further section 23 consultations in respect of all NTS and DN-GT licences that will occur following hive-down of the four relevant DNs from Transco to four wholly owned subsidiary companies:

- ◆ the first of these is planned for May 2005 and will seek to implement changes to incorporate (amongst other things):
  - ◆ the interim incentive arrangements; and
  - ◆ changes required to reflect the outcome of Transco's pricing consultations, for example, if the TO or SO commodity charges are to be passed through the DNs then changes will be required. Furthermore, changes may be required to ensure that charging and revenue recovery is consistent with the DTI's proposed alternative arrangements for independent systems.
- ◆ the second of these is planned for July 2005 following sale of the shares in the four relevant wholly owned subsidiary companies by Transco to

third party purchasers and will seek (amongst other things) to implement the enduring incentive arrangements.

3.189. The detailed drafting of the conditions relating to this issue is discussed in more detail in Chapter 4 of this document in the subsections on Special conditions 28A and 28B. The related conditions are provided in Appendices 8C and 8E (**Special Condition C8A**: Revenue Restriction Definitions in respect of the NTS transportation owner activity and NTS system operation activity; **Special Condition C8B**: Restriction of revenue in respect of the NTS transportation owner activity and the NTS system operation activity. **Special Condition C9**: Allocation of revenues and costs for calculation under the price control in respect of the NTS transportation owner activity and NTS system operation activity. **Special Condition C10**: Supplementary provision of the revenue restrictions in respect of the NTS transportation owner activity and NTS system operation activity. **Special Condition C12**: Restriction of prices in respect of tariff capped metering activities. **Special Condition C14**: Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the NTS transportation owner activity and the NTS system operation activity. **Special Condition E2A**: Revenue Restriction Definitions in respect of the Distribution Network. **Special Condition E2B**: Restriction of revenue in respect of the Distribution Network transportation activity. **Special Condition E3**: Allocation of revenues and costs for calculations under the price control in respect of the Distribution Network. **Special Condition E4**: Supplementary provisions of the revenue restrictions in respect of the Distribution Network; **Special Condition E5**: Restrictions of prices in respect of tariff capped metering activities; and **Special Condition E6**: Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the Distribution Network).

**3.190. Respondents are invited to provide comments on the licence drafting issues relating to price controls.**

### ***Financial reporting***

3.191. This section sets out Ofgem's proposals regarding the financial reporting for NTS and DN-GTs.

## **Next steps document**

- 3.192. In the next steps document, Ofgem stated that it intended, in relation to a number of financial information conditions, where appropriate, to ensure consistency across network licences. Ofgem noted that a number of financial conditions were being revised as part of the Distribution Price Control 4 (DPCR 4) licence consultation for electricity DNOs.

## **Respondents' views**

- 3.193. Detailed comments provided by respondents with respect to the drafting for each of the financial conditions are provided in the Chapters 4 in the discussion on Standard Conditions 30, 30A, and 47 and Special Conditions 2, 3, 4 and 5. context of and in Chapter 5 in the discussion on Standard Special Condition A40.

### *DISG comments*

- 3.194. The licence condition drafting with respect to the financial conditions has been discussed at a number of DISG meetings since publication of the next steps document, including DISG 29 and DISG 34. Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 3.195. At DISG 34, Ofgem stated that proposed Standard Special Condition A29 (Change of Financial Year) and Standard Special Condition A30 (Regulatory Accounts) had been revised in the light of the DPCR 4 consultation to bring such conditions into line across network licences. Ofgem further stated that changes to the Regulatory Accounts condition included the removal of the requirement to produce current cost regulatory accounts and to provide unaudited regulatory profit and loss account accounts, and in addition to move to a "fairly presents" rather than a "true and fair" audit opinion.
- 3.196. However, Ofgem noted that, as part of the proposed modification to the regulatory accounts provisions within the electricity DNO licences, a new licence condition relating to the provision of price control review information

was proposed. In Ofgem's view, this new condition is part of the package of changes to the information provision requirements of the electricity DNO licences. As such, Ofgem stated its intention to introduce the equivalent condition into the licences of gas transporters (Standard Special Condition A40: Price Control Review Information).

- 3.197. Following discussions at DISG 34, Ofgem has received comments on these proposals from both NGT and potential purchasers.
- 3.198. NGT acknowledged that the introduction of this condition was a legitimate requirement, but expressed concern that the drafting proposed was unworkable and would present an unacceptable level of regulatory risk. Further details of NGT's views are discussed in Chapter 5 in respect of Standard Special Condition A40.
- 3.199. One potential purchaser stated opposition to the introduction of Standard Special Condition A40. This respondent stated that this condition was extremely controversial, and the subject of extensive debate as part of the DPCR 4 process. This respondent argued that the inclusion of such a condition was not necessary to facilitate DN sales and should therefore be removed.
- 3.200. Another potential purchaser stated that it would be reasonable for the Authority to give a minimum period of notice of two months before the start of the financial year, to allow licensees to have time to implement any necessary reporting arrangements.
- 3.201. Ofgem's proposals
- 3.202. Following consideration of respondents' views, as expressed within formal responses to the next steps document, comments from DISG members, and comments received by Ofgem in relation to the DPCR 4 consultation, Ofgem has developed proposals for modification to the financial conditions within Transco's six GT licences. The modifications proposed are discussed in detail in Chapters 4 in the discussion on Standard Conditions 30, 30A, and 47 and Special Conditions 2, 3, 4 and 5.

- 3.203. A key new proposal relates to the introduction of the Price Control Review Information Condition, which is discussed in further detail in Chapter 5 in the context of Standard Special Condition A40.
- 3.204. In Ofgem's view, the early, accurate and timely provision of information is key to capturing the potential benefits to customers of the DN sales transaction. It is important that Ofgem collects information about the networks that is as comparable as possible in order to inform the price control process. This condition should help to achieve this aim. As a result, Ofgem will take forward a piece of work as part of the price control process to develop the necessary price control review reporting rules that accompany this condition the Regulatory Instructions and Guidance –RIGs). The development of these cost reporting RIGs will draw heavily upon the lessons learnt and the format of the equivalent price control review reporting rules for electricity distribution, and will involve extensive industry consultation on the form and governance of such guidelines. In developing these reporting rules, Ofgem will take into account information from licensees concerning their costs.
- 3.205. However, to reflect the fact that these price control review reporting rules are not yet in place, this condition has been drafted such the licensee is not obliged to comply with the provisions of this condition until such a date as the Authority specifies by writing in a notice (where such a date occurs on or after the date on which the condition becomes effective). The licensee will therefore not be required to comply with the provisions of this condition until the necessary price control review reporting rules have been developed and a full industry consultation in this regard has taken place.
- 3.206. Furthermore, paragraph 3(b) recognises that there may be a lead time for licensees to implement the necessary reporting arrangements and therefore allows the use of estimates, where reasonable, in the first financial year (or part thereof).
- 3.207. Furthermore, Ofgem would note that it is currently the case that, under the provisions of proposed Standard Special Condition A26 (Provision of Information to the Authority), the licensee must furnish the Authority such information as it may reasonably require for the functions that it performs.

3.208. The detailed drafting of the financial conditions for which consistency with the DPCR 4 consultation is proposed is discussed in more detail in Chapters 4 and 5 of this document. The related conditions are provided in Appendix 8A (**Standard Special Condition A29**: Change of Financial Year, **Standard Special Condition A30**: Regulatory Accounts, **Standard Special Condition A36**: Restriction on Activity and Financial Ring Fencing, **Standard Special Condition A37**: Availability of Resources, **Standard Special Condition A38**: Credit Rating of the Licensee, **Standard Special Condition A39**: Indebtedness, **Standard Special Condition A40**: Price Control Review Information).

### ***System operator managed service agreements***

3.209. This section sets out Ofgem's proposals to address service agreements, including System Operator Managed Services Agreements (SOMSAs), between NTS and DN-GTs.

#### **Next steps document**

3.210. In order to facilitate DN sales, Transco will, through its RDN business, provide a number of services to the IDNs. These services will include the SOMSA arrangements.

3.211. In the next steps document Ofgem detailed that, following consideration of respondents' views, it remained of the view that it would not be appropriate to regulate SOMSAs. Ofgem stated that these were commercial contracts between the IDNs and Transco's RDN business which buyers had signed up to as part of the commercial arrangements associated with buying the DN and that it would not therefore be appropriate for these contracts to be regulated. However, Ofgem noted that the revenues of DN businesses were, and would continue to be, regulated but that as it was not proposing to reopen the current price control, charges to customers would not be affected in the period to 1 April 2008.

3.212. Ofgem stated that it did not expect the SOMSAs to remain in place in the long term but that it expected IDNs to set up their own control rooms in approximately 18 months<sup>24</sup>. However, Ofgem detailed that if this were not the

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<sup>24</sup> It is noted that this is dependent on approval of the safety cases by the HSE.



case and these contracts were to continue into the long term it would reconsider this issue and, if appropriate, regulate these agreements.

- 3.213. Ofgem set out that, in view of the fact that it did not intend to regulate these SOMSAs, it would be necessary to adjust the cap for the RDN licensee in relation to de-minimis businesses for the pre-specified period for which these contracts were expected to be in place. Ofgem therefore proposed to introduce a licence condition into the RDN-GT licence augmenting the de minimis cap licence condition.

### **Respondents' views**

#### *NGT*

- 3.214. NGT welcomed Ofgem's initial conclusion that SOMSAs should not be regulated.

#### *Potential Purchasers*

- 3.215. One potential purchaser considered that it would be appropriate for certain of these contracts to be regulated, so that, from a regulatory perspective, the allocation of duties and liabilities can be seen to be consistent with licence obligations. This potential purchaser did not see the regulation of these contracts as creating opportunities to reopen price controls and suggested that appropriate sunset provisions would deal with any such risk.
- 3.216. Another potential purchaser supported Ofgem's view that, in the event that these contracts become enduring arrangements, Ofgem will reconsider this issue and, if appropriate, regulate these agreements. This potential purchaser noted that in light of the decision not to regulate these contracts, Ofgem proposes to adjust the RDN de minimis cap and suggested that a similar adjustment may be required for the IDNs in respect of the interim services they will be providing Transco.

#### *Shippers/suppliers*

- 3.217. One shipper/supplier considered that SOMSAs are likely to persist for much longer than 18 months and this in fact may well prove to be desirable as it may help reduce the motivation of new DN owners to seek to fragment the arrangements inefficiently. This shipper/supplier suggested that the lack of

transparency and regulatory scrutiny of these documents may raise concerns as to the potential scope for discrimination between DNs. This respondent stated that they would prefer to see the standard form SOMSA terms defined as an integral part of the offtake arrangements. Alternatively, this respondent proposed introducing a licence condition effectively regulating these documents beyond the start date of the next price control.

3.218. Another shipper/supplier agreed with Ofgem that, since system operation services are commercial agreements, they should not be regulated, although consideration should be given to those areas where there is potential for adverse impacts on customers, such as safety and emergency response. This shipper/supplier suggested that the introduction of a time limited obligation to provide services on a non-discriminatory basis is appropriate.

3.219. One shipper/supplier preferred the SOMSAs to be subject to regulatory scrutiny to provide the market confidence that these proposed bilateral agreements will not discriminate between DNs and ultimately impact the quality of service delivery to shippers and customers. In addition this shipper/supplier recommended the standard form of these documents be incorporated into the offtake agreements.

#### *DISG comments*

3.220. Issues relating to the proposed treatment of SOMSAs, and the other de minimis activities that would result from DN sales, has been discussed at a number of DISG meetings since publication of the next steps document, including DISG 29, DISG 31, DISG 33 and DISG 34. Industry participants and other interested parties have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

#### **Ofgem's proposals**

3.221. Following consideration of respondents' views, Ofgem continues to consider that it is not appropriate to regulate SOMSAs. Ofgem continues to believe that these contracts are commercial contracts signed up to as part of the DN sales transaction. Therefore, given that the price controls will be unchanged,

customers will be protected and the commercial interests of the two sides of the transaction should not require intervention by the regulator.

- 3.222. In respect of the comments raised by buyers, Ofgem considers that it is the duty of both NGT and any potential purchasers of DNs to ensure that the SOMSAs being entered into do not affect the ability of the GT to comply with any licence obligation or other obligation (including competition legislation) relating to non-discrimination.
- 3.223. In respect of the need to raise the de minimis cap, following discussions with NGT and at DISG it has become clear that there will be a number of service agreements between the NTS, the RDN business, and the IDNs that would require extensions to the de minimis caps of each licensee for varying lengths of time. Ofgem has altered its proposal with respect to dealing with these proposals, such that it will issue consents under the licence rather than modify any licence conditions. This is discussed in further detail in Chapter 4 in the context of Special Condition 2.
- 3.224. **Ofgem invites respondents' views on the licence conditions and key issues relating to price controls.**

## ***Standards of performance***

- 3.225. In this section, we consider key issues that relate to standards of performance in the event of DN sales. The key issues fall under two main headings:
- ◆ customer survey obligation; and
  - ◆ connections.

These are considered in turn below.

### ***Customer survey obligation***

- 3.226. This section sets out Ofgem's proposals to ensure that there is an obligation on DN-GTs regarding the conduct of customer surveys.

## **Next steps document**

- 3.227. Transco currently undertakes customer satisfaction surveys of those customers that have experienced either a planned or unplanned non-contractual interruption to supply. However, this is not a licence obligation at present. Following publication of an initial consultation paper on quality of service issues in gas distribution in August 2004<sup>25</sup>, and subsequent discussions with industry, Ofgem has proposed that all DN-GTs should be required to undertake such surveys under a licence requirement.
- 3.228. Ofgem therefore proposed, in the next steps document, to introduce provisions in the licence that oblige each DN-GTs to conduct such surveys and publish results on its website.

### **Respondents' views**

#### *NGT*

- 3.229. NGT has stated that it is content with this condition and is inputting into the revision of the RIGs, which will be a subsidiary document to this proposed licence condition, to incorporate the new requirement.

#### *Potential Purchasers*

- 3.230. One potential purchaser stated that it is happy to accept this obligation. This potential purchaser's only concern was that systems and processes exist within xoserve (the Agency) for the appropriate identification of the customers to be surveyed, and the potential purchaser therefore stated that this is a matter that they will take up with it directly.
- 3.231. Another potential purchaser welcomed Ofgem's decision not to introduce financial incentives associated with this licence condition before the next price control review. Further, this respondent also suggested that it would be more efficient and would ensure a consistent approach if Ofgem (or Ofgem's appointed agent) carried out the survey rather than each licensee appointing an approved independent third party.

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<sup>25</sup> See Ofgem publication 192/04; 'Quality of Service for Gas Distribution Networks – initial consultation', August 2004

3.232. More detailed comments are contained in Chapter 4 in the context of Special Condition 36.

*Shipper/suppliers*

3.233. Three shippers/suppliers responded to this issue. Two of these respondents outlined their support for this obligation with one of these respondents recommending that the obligations within the condition be worded to ensure consistency in reporting methods adopted by the DN-GTs to facilitate comparisons. More detailed comments are contained in Chapter 4 in the context of Special Condition 36.

*DISG comments*

3.234. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (including DISG 29 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2. More detail on DISG comments is in Chapter 4 in the context of Special Condition 36.

**Ofgem's proposals**

3.235. Ofgem agrees that it is important that the reporting obligations adopted by the DN-GTs are consistent. In particular, the RIGs, which sit with this condition, define explicitly the format of the customer surveys as well as how the results should be presented to ensure consistency across DN-GTs. It will be a licence requirement to undertake the customer surveys.

3.236. When this licence condition was previously consulted upon, the number of survey questions had not yet been decided. Ofgem has discussed this issue further and has agreed that the survey of customers that have experienced planned and unplanned non-contractual interruptions to supply should ask 8 and 10 questions respectively.

3.237. Furthermore, modifications are proposed to the equivalent condition for the NTS (Special Condition C16) to introduce equivalent references to RIGs and their modification.

- 3.238. More detail on the drafting of these conditions is provided in Chapter 4 in the context of Special Condition 36.
- 3.239. The detailed drafting of the conditions relating to this issue is discussed in more detail in Chapter 4 of this document. The related conditions (**Special Condition C16**: NTS Performance Reporting and **Standard Special Condition D9**: Distribution Network transportation activity incentive scheme and performance reporting) are provided in Appendices 8C and 8D.

### ***Connections***

- 3.240. This section covers Ofgem's proposals with regard to connections.

#### **Next steps document**

- 3.241. In the next steps document Ofgem noted that, as a result of DN sales, a new licence condition would be required to ensure that appropriate protection for customers requiring connections was in place for all DN-GTs.
- 3.242. Ofgem proposed that it would implement the changes to the Enforcement Order<sup>26</sup>, which the Authority has issued to Transco, at the same time as DN sales related changes were to be made. As Transco's poor performance has affected all categories of customers, not just those covered by the Enforcement Order, Ofgem proposed that the new regime should serve to protect all customers, except those in a reasonable position to benefit from competition. Ofgem proposed to introduce the new regime as follows:
- ◆ a new licence condition imposing overall standards of service in respect of connection services provided to customers currently protected by the Order. Ofgem set out that the licence condition would impose requirements in terms of accuracy challenge arrangements and audit requirements, both of which were part of the Enforcement Order;
  - ◆ an extension of the existing Guaranteed Standards of Performance Regulations made via statutory instrument (SI) under section 33AA of the

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<sup>26</sup> Enforcement Order: The Authority in exercise of its powers conferred by Section 28(1) of the Gas Act 1986 made an order in relation to Transco dated February 1999 in relation to contravention and likely contravention of the standard conditions of the Licence.

Gas Act to impose guaranteed standards in respect of all gas transporters' provision of new/alterd connections to end domestic/non-domestic customers. Ofgem stated that these standards would apply to quotations and attendance on site;

- ◆ the introduction of a voluntary scheme that would effectively apply the guaranteed standards imposed under section 33AA to the customer groups covered by the overall standards to ensure that they would not be disadvantaged by the limitations imposed by section 33AA. Ofgem clarified that Transco had agreed to the implementation of this scheme; and
- ◆ the introduction of the new arrangements on the basis of a formal undertaking from Transco (as early as March 2005). Ofgem set out that these arrangements would be implemented in conjunction with revocation of the Order even though the new licence condition and SI were not scheduled to come in to force until the scheduled time of the proposed transaction. Ofgem detailed that Transco had agreed that it would support the early introduction of the new regime to allow the new arrangements to be established in advance of DN sales.

## **Respondents' views**

### *NGT*

- 3.243. NGT was generally content with this proposed licence condition and the RIGs. NGT considered that the proposed standards would 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. More detailed comments are included in Chapter 5 in the subsection on Standard Special Condition D10.

### *Potential Purchasers*

- 3.244. One potential purchaser supported the approach of including appropriate connections standards in performance standards, and in general accepted the draft licence conditions proposed to deal with this issue.

3.245. Another potential purchaser suggested that whilst the requirements may be applicable to Transco they would be disproportionately onerous upon new DN owners. This respondent suggested changes to the DN drafting and definitions for the frequency of audits, thresholds for connection standards, land enquiries, and specified connection information. Two potential purchasers suggested amendments to the timescales for responding to enquiries.

*Shippers/suppliers*

3.246. Four shippers/suppliers supported placing obligations on all GT licensees to ensure that current obligations that are placed on Transco with regards to standards of performance in relation to connections continue to apply. One respondent noted that the obligations should not be overly onerous and that any liabilities could be avoided by the provision of a reasonable service to customers. Furthermore, one shipper/supplier stated that these proposals do not yet deliver the right behavioural incentives on transporters and moreover, in the case of Transco, may actually reduce the overall financial incentive. One shipper/supplier argued that robust monitoring of overall performance was required to ensure that customer service standards do not further deteriorate.

*DISG comments*

3.247. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (including DISG 29, DISG 34 and DISG 35). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.

3.248. Licence drafting was provided to DISG 35 showing a change in the proposed target level for achievement of the service standards from 90% to 95%, as well as an extension to the timeframes within which the standards needed to be achieved.

3.249. However, this prompted a number of concerns amongst potential purchasers as detailed in the minutes of that meeting. Furthermore, following that meeting a number of potential purchasers reiterated the points they had made.



- 3.250. One potential purchaser stated that the changes proposed did not need to be introduced as part of the DN sales process and, if required, an appropriate licence condition could be set once new owners have had an opportunity to operate the networks for a period. This potential purchaser further argued that the existence of standards of performance should be sufficient. This potential purchaser noted that the standards were more onerous than in the consultation and, furthermore, did not take account of the fact that, statistically, individual DNs would find 95% standards tougher to meet than a national company because the number of quotes is much smaller.
- 3.251. Another potential purchaser expressed concern at the overall standards being in the licence, with the consequent issues concerning breach of licence for failure. This potential purchaser noted Ofgem's concern in relation to the continuing performance of Fulcrum, who will be providing subcontractor services, but stated a preference for connections to be treated in the same way as other overall standards of service. Failing this, this potential purchaser stated that they would prefer starting off at the 90% level, rather than 95%, with a move to the latter over a relatively short period of time, as this would allow them to understand more of the real problems and what they should do about them.
- 3.252. It was also noted that this licence condition should not allow Transco to smooth its performance across its four RDN businesses, but the standard performance should apply to each RDN separately.

### **Ofgem's proposals**

- 3.253. Ofgem's connections industry review for 2003/2004 showed clearly that whilst competition in connections was well developed in the market for new build developments, the market for one off connections was not subject to competitive market arrangements. Therefore, to protect the interests of customers who are unable to benefit from effective competition in connections, Ofgem believes that it is necessary for all DN-GTs to be subject to a connections specific licence condition. Ofgem has set the standards which it considers reasonable and proportionate to protect the interests of customers. In setting these standards, Ofgem has considered the arrangements in electricity and has additionally analysed Transco's current standards of performance (both across GB and in individual DNs).

- 3.254. The licence condition and the amended regulations will provide incentives for all DN-GTs to provide reasonable connection services to end customers and other customer groups who currently rely on Transco for connection services i.e. shippers, suppliers, other gas transporters and independent connection providers.
- 3.255. Ofgem will be monitoring the performance of all DN-GTs. Ofgem intends to publish DN-GT performance on an annual basis, as part of Ofgem's annual connections industry review.
- 3.256. However, following consideration of respondents' views, Ofgem has amended the licence drafting presented at DISG 35 such that the service standard targets are 90% rather than 95%, but that the extended periods for compliance with these targets remain.
- 3.257. The detailed drafting of this proposed licence condition is considered in more detail in Chapter 5 of this document, in the context of Special Condition D10.. The proposed licence condition (**Standard Special Condition D10: Provision of connections information**) is provided in Appendix 8D.
- 3.258. **Respondents are invited to comment on the issues and proposed drafting relating to standards of performance.**

### ***Business separation***

- 3.259. In this section, we consider key issues that relate to business separation requirements in the event of DN sales. The key issues fall under two main headings:
- ◆ conditions requiring the separation of **competitive and monopoly** activities; and
  - ◆ conditions requiring the separation of **Transco's NTS and RDN businesses**.
- 3.260. These are considered in turn below.

## ***Separation of monopoly and competitive activities***

3.261. This section sets out Ofgem's proposals for business separation between monopoly and competitive activities

### **Next steps document**

3.262. In the next steps document Ofgem stated that, having considered respondents' views, it viewed it as appropriate to update the business separation requirements largely to align the gas business separation requirements with those that apply in the electricity industry.

3.263. Ofgem set out that, at a high level, the electricity regime requires electricity DNOs to:

- ◆ put in place managerial and operational systems which prevent any relevant supplier from having access to confidential information; and
- ◆ manage and operate the distribution business in a way that does not restrict, prevent or distort competition.

3.264. Ofgem detailed that DNO licensees are also required to have in place a statement describing the practices, procedures and systems that they have adopted to ensure that these conditions are met.

3.265. In relation to separation of NTS and DN-GTs from affiliated IGTs, Ofgem considered that the non-discrimination provisions within the existing regime, together with Ofgem's wider competition powers would be sufficient to address any concerns.<sup>27</sup>

### **Respondents' views**

#### *NGT*

3.266. NGT considered that the proposed Standard Special Condition A33 as drafted would require Transco to prevent various people, including its meter-related services business, from having access to confidential information (e.g.

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<sup>27</sup> This issue is discussed further in Chapter 5 - Amended Standard Condition 4D (proposed Standard

information regarding pressure etc and data-loggers). NGT was concerned that there is no provision for Ofgem to consent to Transco passing confidential information to any class of prohibited recipient (as currently exists).

3.267. NGT stated that if this is not addressed Transco (itself or through an affiliate) and other relevant GTs would be unable to conduct the Industrial and Commercial (I&C) meter business. Furthermore, Transco would be forced to cease to provide the transitional services agreed as part of the Review of Gas metering Arrangement (RGMA) process.

3.268. Transco also suggested that exceptions from the definition of confidential information currently contained in Amended Standard Condition 39 should be included in Standard Special Condition A33 in order to preserve an appropriate limitation on the definition of confidential information. NGT argued that it is not reasonable or appropriate to prevent disclosure of information where the shipper or supplier (in effect the owner of the information) consents to such information being disclosed.

#### *Potential purchasers*

3.269. One potential purchaser agreed with the proposals and welcomed the fact that reliance is primarily being placed upon existing licence conditions, rather than through the imposition of onerous new reporting requirements that would create costs. This respondent also agreed that further ring-fencing conditions were not required. Detailed comments are included in Chapter 4 in the context of Amended Standard Condition 39.

#### *Shippers/suppliers*

3.270. One shipper/supplier believed that further consideration should be given to the position of companies involved in competitive and regulated activities covering both gas and electricity markets, to ensure adequate separation is taking place and suggested that this should be monitored on an ongoing basis by Ofgem.

- 3.271. Another shipper/supplier noted that this condition may need amendment to encompass holders of electricity generation licences which are affiliated or related undertakings of the licensee.

*DISG comments*

- 3.272. The licence condition drafting for these conditions was discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 30, DISG 34 and DISG 35). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.
- 3.273. NGT stated that there was currently no provision in the current drafting for Ofgem to consent to Transco passing confidential information to any class of prohibited recipient (as currently exists). They added that if this was not addressed, the consequence will be that Transco (itself or through an affiliate) and other GTs would be unable to conduct their I&C meter business. Furthermore, Transco would be forced to cease to provide the transitional services agreed as part of the RGMA process. In order to solve this problem, they suggested that the restriction on the passing of confidential information in Standard Special Condition A33 should be subject to a "save where the Authority otherwise consents" provision. Furthermore, they suggested that the exceptions from the definition of confidential information contained in paragraphs 2(b), 2(c) and 2(d) of the current Amended Standard Condition 39 should be included in Standard Special Condition A33 in order to preserve an appropriate limitation on the definition of confidential information.
- 3.274. NGT also commented that sub-paragraph 2(c) of the equivalent electricity distribution condition was unclear as it was not clear what information would class as "corporate".
- 3.275. In commenting upon the drafting of the new business separation conditions proposed, as discussed in Chapter 5 in the context of Special Conditions C19, C20, C21 and E10, NGT stated that the obligations to ensure compliance with the statement should be consistent across competitive/monopoly business separation conditions and NTS/RDN separation conditions. When commenting upon the same NTS/RDN business separation conditions, one potential

purchaser stated that the obligation upon Transco in this regard should be a “best endeavours” obligation.

- 3.276. Following consideration of respondents’ views in this regard, Ofgem stated at DISG 35, that it proposed to ensure consistency across business separation licence conditions by moving all obligations for compliance to “best endeavours”.
- 3.277. One potential purchaser expressed concern at this proposal and stated that this went beyond the changes required for DN sales. This potential purchaser stated that the existing reasonable endeavours obligation has proved to be sufficiently robust within the electricity regulatory regime and there was therefore no reason why it should not be so for the equivalent gas regime. This potential purchaser stated that they firmly believed that the existing "reasonable endeavours" drafting should be retained, with "reasonable endeavours" also retained in respect of the proposed NTS/RDN business separation licence conditions for consistency.

### **Ofgem’s proposals**

- 3.278. Ofgem believes that the conditions proposed are sufficient to give adequate protection against any undue discrimination between monopoly and competitive activities. As far as is practicable, these licence conditions have been developed largely to align with the requirements that are presently in place on electricity distribution licensees. However, as stated above, following consideration of respondents’ views and those expressed at DISG, Ofgem now considers that it is appropriate to change the reasonable endeavours obligation for compliance with the business separation statements to a best endeavours obligation. This is because of the importance that Ofgem attaches to the need to ensure business separation.
- 3.279. Following consideration of respondents’ views, the drafting proposed for Standard Special Condition A33 has therefore been modified relative to the equivalent electricity distribution provisions in four ways:
- ◆ in response to NGT’s concerns regarding the enduring consent, the drafting of paragraph 2(a) has been amended to insert the words “or any meter asset manager (bearing the meaning of that expression contained

in Standard Special Condition A10 (Provision and Supply of Meters)), as requested by NGT;

- ◆ sub-paragraph 2(c) of the electricity drafting has been deleted, due to the lack of clarity in the drafting of this sub-paragraph with respect to “corporate” information, and replaced with the words “unless the Authority otherwise consents in writing” to address NGT’s concerns on transitional consent, and allow for the possibility of derogations being granted by the Authority;
- ◆ paragraph 7 has been modified to oblige the licensee to revise their statement should their circumstances change; and
- ◆ the obligation to comply with the statement in paragraph 8 has been strengthened from “reasonable measures” to “best endeavours”. This change followed a respondent’s view that the requirements on the transmission for separation should be for it to use its best endeavours rather than reasonable and NGT’s view that the arrangements between competitive/monopoly should be at least as strong as those required between network businesses.

3.280. The detailed drafting of these proposed licence conditions is considered in more detail in Chapter 4 of this document. The proposed licence conditions (**Standard Special Condition A33: Restriction on Use of Certain Information and Independence of the Transportation Business** and **Standard Special Condition A34: Appointment of Compliance Officer**) are provided in Appendix 8A.

### ***Separation of NTS and RDNs***

3.281. This section considers the key issues that relate to NTS and RDNs.

#### **Next steps document**

3.282. In the next steps document Ofgem stated that the Authority had reviewed its “minded to” decision on requiring legal separation of the NTS and the RDNs as a result of issues associated with its implementation. In this regard Ofgem detailed that it had developed a set of licence obligations, designed to address the issues

that could arise as a consequence of the Authority decision not to require legal separation.

- 3.283. Ofgem stated that the Authority's views in relation to targeted structural separation, which were previously set out in the Offtake Arrangements Conclusions document, remained unchanged. Ofgem explained that Transco would be required to have a statement in place describing the practices, procedures and systems it had adopted to ensure no undue discrimination between RDN and IDN businesses. Ofgem outlined that, in particular, the statement would set out how, and to what extent, Transco would maintain informational, operational and physical separation between the NTS and RDN businesses so as to prevent any breach of the requirement for no undue discrimination by the NTS.

### **Respondents' views**

#### *NGT*

- 3.284. NGT stated it had consistently maintained that the scope for undue discrimination by a network monopoly business is both narrower 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.

#### *Potential purchasers*

- 3.285. One potential purchaser stated a preference for the legal separation of the NTS and RDNs, but accepted that there were obstacles to doing this. Another potential purchaser supported the approach taken by Ofgem.
- 3.286. Another potential purchaser noted that, if the Authority has not indicated otherwise within 60 days of receipt, the statement prepared by Transco as to how it will ensure separation will be deemed to be approved. This potential purchaser suggested that, given the importance of this statement, there should not be any form of deemed approval and that Ofgem should positively approve the statement. This respondent also questioned the use of the phrase "managerial boards". This respondent also suggested that given the importance of the statement in ensuring separation there should be at least a best endeavours



obligation rather than a reasonable measures obligation to ensure compliance with the statement on Transco.

- 3.287. This potential purchaser also questioned how Transco would enforce the NTS/DN operator agreement in relation to the RDNs given that they were the same company and noted the absence of a licence condition on Transco requiring it to enforce contractual obligations in relation to the RDNs as though they were separate businesses. This potential purchaser suggested that it would be preferable to include a licence condition that obliges the NTS licensee to behave in relation to the RDN businesses as though it were a separate company not affiliated to the licensee including entering into written arrangements and taking enforcement action in relation to those arrangements as far as possible as though they were separate companies.
- 3.288. This potential purchaser also suggested that the licence condition should require Transco to be audited.
- 3.289. A potential purchaser also questioned whether it would be more appropriate for the undertaking from the ultimate controller within Special Condition C19 should be in favour of the Authority as opposed to the licensee.

#### *Shippers/suppliers*

- 3.290. Shippers/suppliers raised a number of issues. One shipper/supplier stated that the services which can be provided should be explicitly specified, both in this condition and the separation conditions specific to NGT. This supplier/shipper also stated that the condition should require an independent audit opinion as to whether the activities of the compliance officer are sufficient to ensure compliance with the assigned licence conditions. This shipper/supplier stated that if the practices and procedures necessary for separation have not been implemented by 1 May 2005, a specific time limit for implementation should be given, perhaps tied to the date of share sale, to give confidence to the community that stringent protections are in place. Furthermore, this shipper/supplier noted that a certain proportion of the members of the management boards should not be members of both boards, to ensure a healthy balance of views and that some form of Code of Conduct should apply to members of the Transmission Executive Committee (TEC) and the Distribution Executive Committee (DEC) who are also members of the Transco Board. This

shipper/supplier also stated that an additional standard special condition in Part D of the licence, was required to address separation requirements between DNs where more than one DN is owned by the same ultimate controller.

- 3.291. Other comments raised by shippers/suppliers stated that the gas regulatory regime should follow a similar framework to that prescribed within the electricity market and that Ofgem should actively carry out the reporting and auditing of adherence thereof, particularly for those gas network owners who are also engaged in a number of related activities across the energy markets. Another shipper/supplier noted that NGT's proposed merger of Transmission Metering Services (TMS) and Onstream needed to be considered in light of this condition. Furthermore, one shipper/supplier stated that introducing licence conditions instead of legal separation would appear to be contradictory to the approach being taken on exit arrangements where licence conditions are considered insufficient to prevent undue discrimination. Detailed comments are included in Chapter 5.

#### *DISG comments*

- 3.292. The proposed licence condition drafting for these conditions was discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 30, DISG 34 and DISG 35). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 3.293. At DISG 34, Ofgem agreed with the comment raised by a potential purchaser that the obligation on Transco with respect to compliance with the statement relating to business separation between the RDNs and the NTS should be that of "best endeavours" instead of that of "reasonable endeavours".
- 3.294. NGT stated that a "best endeavours" obligation on UK Transmission to comply with its compliance statement was excessive and inappropriate. NGT pointed out that the equivalent electricity DNO standard condition is "reasonable" (where the risks of unfair competition and unfair competitive advantage were, in its view, greater in number and consequence). NGT argued that it would be perverse to apply a higher standard to an area of activity that carries lower risk and consequence.

3.295. NGT therefore argued that the obligation should revert to that of “reasonable endeavours”. More detailed comments are included in Chapter 5 in relation to Special Conditions C19, C20, C21 and E10.

### **Ofgem’s proposals**

3.296. Ofgem continues to believe that the licence conditions which relate to the separation of NTS and RDN activities are needed so as to ensure that as far as possible the effect of actual legal separation is largely achieved, in line with the views of the Authority.

3.297. In the next steps document, drafting was presented for a licence condition (Special Condition C19) which required a legally enforceable undertaking from the ultimate controller in favour of the licensee to ensure that the NTS operator does not discriminate in favour of its own affiliated businesses and places an obligation on the NTS licensee not to enter into contractual terms with its affiliated business materially/unduly different from those contracts entered into with other gas transporters. Ofgem notes respondents’ views with respect to this condition, and remains of the view that the undertaking of the ultimate controller should be in favour of the licensee. However, an additional paragraph (paragraph 2) has been introduced, consistent with the drafting of Standard Condition 45 regarding the enforceability of such an undertaking.

3.298. Furthermore, since the last consultation document Ofgem has consulted on the drafting of an additional licence condition which covers the issue of separation of the NTS and RDN businesses.

3.299. This condition requires that Transco has in place appropriate managerial and operational protections to ensure that the NTS does not discriminate in favour of its RDN business. It requires the NTS to have in place a statement of compliance, which outlines those practices, procedures and systems, adopted by the NTS to comply with this condition. The condition also requires that Transco has in place separate managerial boards for each of the GT businesses in relation to the NTS and the RDNs. These managerial boards will be responsible for taking all substantial decisions relating to the NTS and RDN businesses and will have at least two Transco directors. Such boards will take decisions in respect of these relevant businesses only.

- 3.300. Furthermore, Ofgem has taken into consideration respondents' views in relation to the "reasonable measures" reference within these licence conditions.
- 3.301. Following consideration of the views of NGT following DISG, Ofgem continues to consider that the "best endeavours" obligation for compliance with the statement is appropriate. However, Ofgem agrees that compliance with respect to business separation between the monopoly and competitive businesses of GTs is equally important and has therefore also proposed that the obligation in relation to such compliance should be that of "best endeavours" also. This change is set out in the monopoly/competitive business separation section above.
- 3.302. Ofgem has introduced an additional condition in relation to the NTS requiring it to appoint a compliance officer and outlining the main duties of that role, namely, ensuring that the compliance officer oversees the tasks outlined in the compliance statement. This condition also requires that the compliance officer reports annually to a compliance committee on how they have complied with the requirements of the licence.
- 3.303. Ofgem will consider carefully the statements that NGT provide to implement these proposals and will consult DISG on non-confidential issues.
- 3.304. The detailed drafting of these proposed licence conditions is considered in more detail in Chapter 5 of this document. The proposed licence conditions (**Special Condition C19**: Undertaking from ultimate controller concerning non-discrimination between the NTS transportation activity and the Distribution Network transportation activity, **Special Condition C20**: Separation of NTS and Distribution Network Businesses, **Special Condition C21**: Appointment and duties of the business separation compliance officer, **Special Condition E10**: Separation of NTS and Distribution Network Businesses) are provided in Appendices 8C and 8E.
- 3.305. Respondents are invited to comment on the proposed drafting and the issues associated with business separation.**

## ***Treatment of LNG storage and Metering***

3.306. In this section, we consider key issues that relate to the treatment of LNG and metering in the event of DN sales. These are considered in turn below.

### ***Treatment of LNG storage***

3.307. In this section we consider the key issues regarding LNG storage.

#### **Next steps document**

3.308. As part of the restructuring of the obligations in Transco's licence it has been necessary to consider whether obligations relating to LNG, storage and metering should sit within the NTS licence, the DN licences or both.

3.309. In the next steps document, Ofgem considered that following consideration of the responses to the September document, obligations relating to LNG storage should sit within the NTS-GT licence only. As the LNG provisions had been introduced into Transco's licences through amendments to the standard conditions, Ofgem proposed that the:

- ◆ standard special conditions applicable to both the NTS and DN licensees would revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State;
- ◆ licence conditions that relate exclusively to LNG storage would be NTS special conditions; and
- ◆ a new special condition would be placed upon the NTS which would seek to "augment" standard special conditions as appropriate.

#### **Respondents' views**

##### *NGT*

3.310. NGT did not make any comments on the proposed treatment of LNG storage provisions within their licences.

##### *Potential purchasers*

- 3.311. Two potential purchasers supported Ofgem's proposals to place all existing licence obligations relating to LNG storage in Transco's NTS-GT licence as a special condition.
- 3.312. Two potential purchasers pointed out that the effect of reverting to references to storage facilities contained in the standard conditions designated by the Secretary of State was that references to offshore gas storage installations, storage cavities in natural strata and containers for the storage of gas in a liquid state were being reintroduced. These references were not currently in Transco's licence and therefore the purchasers argued that their reintroduction was outside of the remit of DN sales. Further detailed comments are set out in Chapter 5 in the context of Special Condition C1.

*Shippers/ suppliers*

- 3.313. One shipper/supplier raised a number of concerns in relation to the treatment of LNG storage and issues relating to the energy value and arrangements in relation to boil-off gas and the commercial arrangements for LNG storage and LNG Import facilities.

*DISG comments*

- 3.314. The licence condition drafting for these conditions was discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 31, DISG 32 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 3.315. Potential purchasers again expressed their concern regarding the reintroduction of references to offshore storage installation, storage cavities in natural strata and containers for the storage of gas in a liquid state within the DN-GT licences. Ofgem accepted these concerns and presented revised licence drafting removing these references.
- 3.316. One potential purchaser supported Ofgem's proposals to remove the references to offshore storage installation, storage cavities in natural strata and containers for the storage of gas in a liquid state from the DN-GT licences.

### **Ofgem's proposals**

- 3.317. Following consideration of respondents' views, Ofgem agrees with the potential purchasers that the LNG provisions should be included in a special condition on the NTS licensee and that references to storage within the DN-GT licences should be removed.
- 3.318. Ofgem notes the issues raised in relation to commercial arrangements in relation to the treatment of LNG storage and boil-off gas and considers that these issues should be addressed through the UNC.
- 3.319. The new LNG storage condition for the NTS is discussed further in Chapter 5 and the detailed drafting of the condition is attached to this document (**Special Condition C1: Amendments to Standard Special Conditions relating to LNG**).

### ***Metering***

- 3.320. In this section, we consider the key issues in relation to metering.

### **Next steps document**

- 3.321. Following consideration of the views of respondents to the September document, Ofgem stated in the next steps document, that obligations relating to metering should sit within both NTS and DN-GT licences as both would need to undertake metering activities (or be responsible for arranging metering services).

### **Respondents' views**

#### *NGT*

- 3.322. NGT did not comment on Ofgem's proposals relating to the treatment of metering obligations.

#### *Potential Purchasers*

- 3.323. The potential purchasers have, in written responses to the next steps document, expressed significant concern at the proposal to place metering obligations in the DN-GT licences.

- 3.324. One potential purchaser was concerned that, under the proposals set out by Ofgem, the IDNs would be required to be metering providers of last resort where, unlike the RDNs they would have no regulated metering business with which to fulfil the obligation. This potential purchaser recognised that the IDN would be able to procure the services required to fulfil the obligation. This potential purchaser also noted that the Transco metering business will continue to provide metering services to existing meters within the IDNs and have a significant metering presence in each of the IDN areas (as the metering assets will not be transferred as part of the DN sales). This potential purchaser therefore considered that Transco's metering business should be required to extend this service to any new meters following the sale of the DNs.
- 3.325. Another potential purchaser considered that the IDN, as a new entrant, was not best placed to provide or deliver last resort metering services in an economically efficient manner which is not in the customers' interest. This potential purchaser considered that this activity may not be covered by the existing price control.
- 3.326. A potential purchaser also expressed concern that insufficient consideration had been given to the impact the proposed arrangements will have on the Review of Gas Metering Arrangements (RGMA) processes. For example, the changes that will have to be made to the RGMA baseline and associated metering systems to recognise IDNs where they are required to be the Gas Act owner. This potential purchaser stated that, at present, the RGMA baseline and all associated electronic flows assume that the Meter Asset Manager is Transco where the GT is the Gas Act owner. They stated that it was currently unclear what the impact of the metering obligation being applied to IDNs would be. They stated that there was a risk that the changes to these systems and processes could represent a significant tranche of work.

#### *Shippers/suppliers*

- 3.327. One shipper/supplier stated that provisions need to be retained for both NTS and DNs and this proposal reflects the current thinking on NTS unique sites where it is proposed that the metering is retained by the NTS and does not form part of the competitive metering market covered by RGMA.

#### *DISG comments*



- 3.328. The drafting for these conditions was discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 3.329. At these meetings, potential purchasers reiterated their concerns regarding the provision of meter provider of last resort services, as discussed further in Chapter 4 in the context of Amended Standard Condition 8.

### **Ofgem's proposals**

- 3.330. Ofgem continues to believe that it is inappropriate for Transco's RDNs to have an obligation to provide metering of last resort to customers on an IDN network. Instead, Ofgem considers that it is possible for potential purchasers to discharge these obligations potentially through a third party. Ofgem's view is that these obligations are related to each IDN's role as a GT and that it would be inappropriate to place the obligations on Transco. We therefore continue to propose that metering obligations will be placed in all NTS and DN-GT licences.
- 3.331. In relation to concerns regarding RGMA baselines, Ofgem notes that the RGMA baseline details the data flows and processes that must be made between the supplier, shipper, transporter and MAM. Furthermore, RGMA was developed on the basis that any supplier could contract with any MAM. The RGMA baseline is managed and governed under the Supply Point Administration Agreement (SPAA), which all GTs are obliged to become a party to and comply with under the provisions of Standard Condition 14 of their licence. All SPAA signatories can propose changes to the RGMA baseline. Any proposed changes to the RGMA baseline are reviewed and the impact of such proposals is assessed by the industry before a decision is reached. The SPAA governance structure therefore provides a forum for any concerns to be discussed as all interested parties are represented.
- 3.332. The metering conditions are discussed further in Chapter 4 (in the context of Amended Standard Condition 8, Amended Standard Condition 17, Amended Special Condition 31, and Special Condition 32) and the detailed drafting of these conditions (**Standard Special Condition A10: Provision and Return of**

Meters, **Standard Special Condition A19**: Provision of Services for Persons who are of Pensionable Age or Disabled or Chronically Sick: Arrangements in Respect of Meters, **Standard Special Condition A43**: Provision of Metering and Meter Reading services, **Standard Special Condition A46**: Non-discrimination in the provision of metering activities, **Special Condition C12**: Restriction of prices in respect of tariff capped metering activities, and **Special Condition E5**: Restriction of prices in respect of tariff capped metering activities) are provided in Appendices 8A, 8C and 8D.

- 3.333. **Respondents are invited to comment on the proposed new licence conditions and issues relating to LNG Storage and metering.**

## ***Arrangements for Independent systems***

### **Description**

- 3.334. Under the provisions of Special Condition 18 of Transco's original GT licences, customers connected to independent networks should be charged an average price for conveyance which is "no more than the average charge for conveyance to premises in Great Britain" as at 1 March 1996 and adjusted each year thereafter in line with the Retail Price Index. In the case of the LPG networks, Transco, on behalf of customers, is required to subsidise the cost of the gas itself, as well as the costs of conveyance.

### **Next steps document**

- 3.335. In the next steps document Ofgem detailed that the Authority had asked the Department of Trade and Industry (DTI) to review Special Condition 18 in Transco's original GT licence. Ofgem stated that during the implementation of the Gas Act 1995, the DTI took the view that customers connected to independent systems that were supplied with LNG and LPG should not be denied the advantages of competition. Ofgem set out that as a result, Special Condition 18 was a condition that was included in Transco's GT licence, on 1 March 1996, at the DTI's behest.
- 3.336. In the next steps document Ofgem outlined that there were five independent LNG networks in Scotland and four independent LPG networks (in Scotland, Wales and the North of England). Ofgem stated that all of these networks were

independent networks when Special Condition 18 was introduced (i.e. separate from the main GB gas transportation system), and that all of these systems, bar one, remain independent.

3.337. Ofgem highlighted that the DTI would be issuing a position paper in due course to inform the industry of the way in which it proposes to take this matter forward. Ofgem explained that the DTI wished to notify all relevant parties that the review would be taking place and that it would welcome comments from respondents on this issue. In this regard Ofgem set out that following the outcome of the DTI's review of the provisions of Special Condition 18, any changes necessary to Transco's six GT licences would be implemented as part of the formal section 8AA (and associated section 23) consultation.

### **DTI position paper**

3.338. The DTI issued a position paper in January 2005. In this paper, the DTI outlined its proposed policy that the existing arrangements for the independent systems should continue, such that:

- ◆ consumers connected to independent networks are charged an average price for conveyance which is no more than the average charge for conveyance to premises in GB;
- ◆ this average price is calculated annually; and
- ◆ independent gas networks that have subsequently connected to the main gas network (e.g. Stranraer) will be excluded from the arrangements for independent gas networks through a sunset clause.

3.339. The DTI further stated that, should Transco's proposed sale of DNs proceed, the Secretary of State would issue Transco with a Determination (under Amended Standard Condition 29 of Transco's original licence) to confirm what "alternative arrangements" are suitable and should apply. The DTI also noted that the appropriate changes to Transco's six GT licences would be implemented by Ofgem as part of the formal consultation under section 8AA and Section 23 of the Gas Act.

3.340. The DTI's position paper deviates from the drafting of Special Condition 18 as it currently stands in the following ways:

- ◆ charges are constrained to the average GB charge in each year, rather than the average GB charge in March 1996, inflated with respect to RPI; and
- ◆ that the protection afforded to customers connected to the Stranraer network (which has since been connected) will be removed.

3.341. Given the way in which the alternative arrangements are currently implemented, it is expected that the day one impact upon customers connected to these networks will be negligible, if not zero, as:

- ◆ charges are already levied by Transco as the average GB charge in each year, rather than the average GB charge in March 1996, inflated with respect to RPI; and
- ◆ given the current structure of DN charges, Stranraer customers are expected to be charged the same as all other customers within the Scotland DN.

### **Respondents' views**

#### *NGT*

3.342. NGT has stated that it will implement the arrangements proposed by the DTI, and that further changes to the licence to reflect any changes to charging arrangements will be implemented as part of a section 23 process subsequent to hive-down.

#### *Potential Purchasers*

3.343. One potential purchaser noted that this condition is subject to a DTI position paper, that at the time was, to be issued in due course. Further details can be found in Chapter 4 in the context of Special Condition 18.

#### *Shippers/suppliers*

3.344. One shipper/supplier was concerned to note that there did not currently appear to be a replacement licence condition in respect of Special Condition 18. Whilst they appreciated that the DTI was considering the issues raised by those areas,

they believed that the existing text should be included as an interim measure prior to the drafting of revised text.

#### *DISG comments*

3.345. These issues were discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants and other interested parties have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

#### **Ofgem's proposals**

3.346. Given the DTI's proposals, Special Condition 18 will be deleted and the alternative arrangements determined as suitable by the Secretary of State will no longer refer to the provisions of this condition. Ofgem is proposing a number of minor amendments to reflect the DTI's proposals in this area. These changes include:

- ◆ the deletion of Special Condition 18, on the understanding that the "alternative arrangements" determined by the DTI will sit outside of the licence;
- ◆ changes to the "disposal of assets" licence condition such that:
  - ◆ references to Special Condition 18 are removed;
  - ◆ consent to the disposal of these particular assets will only be required with respect to independent systems that remain independent; and
  - ◆ to ensure that there is enforceability of alternative arrangements; and
- ◆ minor changes to the "obligations as regard charging methodology" condition such that charging methodologies are required to reflect any alternative arrangements put in place in accordance with a determination by the Secretary of State.

- 3.347. The conditions affected are discussed further in Chapter 4 with respect to Special Condition 18 and the detailed drafting of these conditions (**Standard Special Condition A5: Obligations as Regards Charging Methodology**, and **Standard Special Condition A27: Disposal of Assets**) are provided in Appendix 8A.
- 3.348. **Respondents are invited to comment on the issue of independent systems and associated licence drafting.**

### ***Conditions of consent***

- 3.349. As noted in Chapter 2, in its January 2005 decision to grant conditional consent to Transco's four applications to dispose of four of its DN businesses to four wholly owned subsidiary companies, the Authority concluded that in order to protect the interests of customers the enduring offtake arrangements should be implemented by 1 September 2005.
- 3.350. In order to achieve this, the Authority imposed certain conditions to the consent granted to Transco to secure the implementation of the enduring offtake arrangements (including the enduring NTS exit capacity and NTS exit flexibility arrangements) on a best endeavours basis by 1 September 2005. These conditions are intended to apply within the period prior to hive-down and share sale and are discussed in detail in the Authority's February 2005 decision document.<sup>28</sup>
- 3.351. In addition, in its February 2005 decision document the Authority indicated that it intended to propose a number of licence conditions on Transco and the DNs relating to the implementation of the enduring offtake arrangements. These conditions would be intended to operate for the period following hive down and share sale.
- 3.352. In particular, the Authority indicated that it intended to propose licence conditions, binding upon Transco and each of the DNs, requiring them to use their best endeavours to implement the enduring offtake arrangements by 1 September 2005.

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<sup>28</sup> *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks – Authority decision, February 2005*

- 3.353. In addition, the Authority stated that it intended to propose, as part of the licence condition binding upon Transco, an obligation upon it to procure from NGT an undertaking to the Authority that it will use its best endeavours to ensure that the enduring offtake arrangements will be implemented by 1 September 2005.
- 3.354. Further, the Authority stated that it intended to propose, as part of the licence condition binding upon each independent DN, an obligation requiring it to procure an undertaking addressed to the Authority from its ultimate controller that it will use its best endeavours to ensure that the independent DN implements the enduring offtake arrangements by 1 September 2005.
- 3.355. The Authority indicated that Ofgem would consult on these proposed licence conditions in February 2005 as part of the proposed section 8AA and associated section 23 licence modification proposals to Transco's existing GT licences.
- 3.356. As a result of the Authority's decision therefore, Ofgem is now consulting on the proposed licence conditions described above through the section 8AA and associated section 23 Notices that are attached to this document.
- 3.357. Proposals for these licence conditions were discussed at DISG 35. The minutes of this meeting are attached in Appendix A.
- 3.358. This condition is discussed further in Chapter 5 and the detailed drafting of this condition (**Standard Special Condition A55: Enduring Offtake Arrangements**) is provided in Appendix 8A.
- 3.359. **Respondents are invited to comment on the licence drafting relating to this issue.**

## 4. Existing Transco plc licence conditions

- 4.1. Before any sale of DNs can proceed it will be necessary to modify substantially Transco's six GT licences to ensure that the interests of customers are protected in a divested industry structure. The modifications to Transco plc's existing standard and special licence conditions are discussed in this chapter. The new licence conditions that Ofgem considers be required to protect the interests of customers in the event of any DN sale are considered in Chapter 5.
- 4.2. Following consideration of respondents' views in response to the informal Section 8AA proposals published in November 2004, and subsequent discussion of further issues by the DISG, Ofgem has developed formal proposals for the changes required as part of the Section 8AA consent (and associated additional section 23 notice).
- 4.3. This chapter therefore includes:
- ◆ a brief description of each licence condition contained within Transco plc's current GT licences;
  - ◆ a high level overview of the changes, proposed by Ofgem as part of the next steps document, required in a divested industry structure;
  - ◆ a summary of the responses received to the next steps document, in relation to proposed changes to each standard and special licence condition;
  - ◆ Ofgem's views and associated proposals in relation to each condition in Transco's GT licences, including its views on the appropriate way forward; and
  - ◆ Ofgem invites respondents' views on the all of the draft licence conditions set out in this chapter. In Chapter 6 we set out the way forward.



## **Overview**

- 4.4. This chapter follows the format of Transco GT licences, in their present structure, and therefore sets out the proposed changes (if any) to:
- ◆ the standard conditions<sup>29</sup> within Transco’s current licences (Sections A, B, and C; and
  - ◆ the special conditions within Transco’s current licences.
- 4.5. The conditions described in Transco GT licences as “not used” are not discussed in this chapter nor are any proposed or pending modifications to such licences which are unrelated to the proposed sale of Transco’s DNs.
- 4.6. Ofgem would also like to make clear that the potential sale of one or more of Transco’s DNs is not a regulatory initiative, but a commercial decision taken by NGT. Accordingly, the proposed modifications, included in this chapter, will only apply to Transco’s licences. As such, the proposed amendments will not apply to GT licences held by IGTs.
- 4.7. In issuing this document it is important to clarify that there can be no expectation on the part of NGT, Transco, potential DN purchasers, shippers, suppliers, IGTs or any other interested parties either as to the outcome or timetable of NGT’s commercial transaction. In addition, there can be no expectation on any decisions that the Authority may make in the future in relation to compliance with conditions to its consent to this transaction. This includes, without limitation, any decision as regards network code modification and/or any licence modification which the Authority concludes may be necessary.

## ***High level principles***

- 4.8. In considering modifications to Transco’s licences, it has been necessary to make a number of minor modifications and apply certain drafting conventions throughout the licence to achieve greater consistency and clarity in the drafting.

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<sup>29</sup> Including Amended Standard Conditions

- 4.9. Such modifications have been applied across a number of conditions, and therefore, they are not described within the relevant sections of this chapter for each condition in which they occur. Instead, a brief summary of some of the more common modifications is provided below which briefly explains why these modifications have been necessary.
- 4.10. In developing drafting conventions and applying these modifications, Ofgem has considered respondents' views on these matters. Particular attention has been given to areas where respondents' have highlighted the greatest lack of clarity or specific inconsistencies.
- 4.11. Inconsistencies noted by certain respondents within the drafting included (but were not limited to) the following:
- ◆ inconsistent or confusing use of network code related definitions;
  - ◆ issues caused by the fact that Transco will hold two licences within a single legal entity (but only one Short Form Code (SFC));
  - ◆ modifications required to reflect the DTI's proposed exemption for NTS and DN-GTs from the requirement to hold a gas shippers licence;
  - ◆ inconsistent use of condition references and inaccuracies in labelling when more specific condition references are applied; and
  - ◆ inconsistent use of capitalisation in defining terms and applying such definitions.
- 4.12. The key elements of Ofgem's approach to dealing with such issues can be summarised as follows:
- ◆ as discussed in greater detail under Amended Standard Condition 1 (Definitions and Interpretation), network code related definitions have been rationalised so that only two terms are defined:
    - ◆ Uniform Network Code (UNC); and
    - ◆ network code (the document prepared by or on behalf of the licensee which shall incorporate by reference the terms of the UNC, unless the Authority otherwise consents in writing).

Network code references throughout Transco's existing licences, in general refer to the "network code". Where references relate to the Network Code of Transco at a particular point in the past, this has been clarified by specifying the date, and referencing Amended Standard Condition 9 of Transco's licence at that time.

- ◆ Transco will hold two licences for its NTS and Retained Distribution Network (RDN) businesses respectively given the Authority decision not to require legal separation, as such, it has been necessary to clarify certain terms throughout the licence so that it is clear whether obligations relate to the NTS business, the RDN business or Transco business as a whole. In order to achieve this, the following modifications have been made:
  - ◆ a definition of "licensee" has been added within Standard Special Condition A3 such that it relates specifically to the NTS business or the RDN business, unless stated otherwise in the condition concerned; and
  - ◆ phrases such as "licensee's pipe-line system" have been amended to " the pipe-line system to which this licence relates" to achieve clarity throughout the licence.
- ◆ Given the DTI's proposals to grant an exemption to NTS and DN-GTs, certain modifications have been made to the licence to reflect the exemption being in place:
  - ◆ the "gas shipper" definition, consistent with the Gas Act, has been applied and the definition of "shipper" within the price control conditions, which included those with an exemption, has been deleted; and
  - ◆ where appropriate, references to gas shippers have been supplemented with references to the NTS operator, DN operators, or "relevant gas transporters".
- ◆ to ensure consistency and clarity, the phrase "this condition" has been applied throughout and shall be interpreted as meaning the

corresponding standard condition, amended standard condition, standard special condition or special condition of that section in this chapter, as the case may be; and

- ◆ the majority of defined terms have been kept in lower case to achieve some consistency in application across the licence.

4.13. The following section summarises the Ofgem views in the next steps document, the views expressed in relation to comments received from respondents to the next steps document as well as comments made at the relevant DISG meetings and sets out the proposals for each existing Transco plc licence condition.

## **Standard Conditions**

### ***Amended Standard Condition 1 – Definitions and interpretation***

#### **Description**

4.14. This condition explains and defines the key terms within the licence unless the context otherwise requires.

#### **Next Steps document**

4.15. In the next steps document, Ofgem stated that it proposed to revert Amended Standard Condition 1 to the designated Standard Condition 1. Ofgem therefore proposed that the definitions included within Standard Condition 1 of the existing licence would apply across the standard conditions as well as the standard special conditions and special conditions. Furthermore, in order to include new definitions to apply to the standard special conditions and special conditions within the licence, a new standard special condition (A3 Definitions and Interpretation) for all NTS and DN-GTs would be implemented.

4.16. Ofgem also stated that, consistent with its decision that LNG storage provisions should be specific to the NTS licence, a new NTS special condition (Special Condition C1, paragraph 1) had been introduced to augment Standard Special Condition A3 with respect to LNG related provisions.

## **Respondents' views**

### *NGT*

- 4.17. NGT did not provide a detailed response on this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.18. Two potential purchasers highlighted the inconsistencies regarding the treatment of definitions. One of these potential purchasers preferred the licence to contain one section for definitions, not least because present practice leads to the same term being defined differently in different conditions and in some instances in the wrong section. Another potential purchaser supported switching off Standard Condition 1 and incorporating any missing definitions into Standard Special Condition A3.
- 4.19. A further respondent noted there appears to be some confusion within the licence concerning the multiple definitions for 'transportation business'. Furthermore, this potential purchaser also stated that there was a need to reflect changes to the existing framework, e.g. "transportation arrangements" must ensure that it provides for GT to GT arrangements that have been proposed. This potential purchaser also highlighted that where shipper and supplier licences refer to standard conditions of the transporter's licence they might need to be modified.

### *Shippers/suppliers*

- 4.20. One shipper/supplier suggested that there were a number of definitions which would need to be amended to reflect ongoing discussions in DISG meetings and other fora, for example, the definition of "consolidated transportation business" which is not needed and should be deleted.

### *DISG comments*

- 4.21. The licence condition drafting for Standard Special Condition A3 and the definitional principles applied, have been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). The minutes of these meetings are attached in Appendix 2. Industry

participants have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings.

### **Ofgem's proposals**

- 4.22. Following consideration of respondents' views to the next steps document, Ofgem's position with respect to definitions within the licence has changed. In this respect, it is intended that Standard Condition 1 will only apply to the existing standard conditions and that Standard Special Condition A3 will apply to the standard special conditions and special conditions within the licence.
- 4.23. Ofgem notes the views of respondents that Standard Condition 1 should be switched off, but is of the view that the definitions applicable to the standard conditions are needed to give the standard conditions context and meaning.
- 4.24. Ofgem considers the concerns of respondents can be partially addressed by having a single definitional condition for all standard special conditions and special conditions. Ofgem consider that this will provide licence holders with greater clarity on where to look within the licence for a certain definition. Ofgem notes that the majority of provisions within NTS-GT licences will be standard special or special conditions.
- 4.25. As a result, Ofgem has brought forward, into Standard Special Condition A3, the definitions used in Standard Condition 1 that are also required for standard special conditions and special conditions. Furthermore, clarification has been provided that definitions in Standard Special Condition A3 will apply to Parts B, C, D, and E of the licence, as well as Part A.
- 4.26. In general, definitions used in more than one condition have been brought forward into Standard Special Condition A3 but there will, however, continue to be condition specific definitions. Examples of definitions brought forward into Standard Special Condition A3 include "balancing management", "capacity rights", "constraint management", "constraint management services", "formula year", "metering activities" and "total system".
- 4.27. Standard Special Condition A3 has also been modified to:
- ◆ delete definitions that are not used such as "consolidated transportation business"; and

- ◆ introduce new definitions or modify existing definitions as appropriate.

4.28. Of the new definitions introduced, key definitions include:

- ◆ **“DN operator” and “NTS operator”**, both of which are defined in relation to the parts of the licence that are operative, i.e. a DN operator is a GT who is obliged to comply with one or more conditions in Part D as a result of any direction issued pursuant to Standard Special Condition D1<sup>30</sup>, and the NTS operator is defined in the same way but in relation to Part B of the licence;
- ◆ **“relevant gas transporter”**, which is used as a collective term in Standard Special Condition A3 and is defined as a gas transporter who is a DN operator or an NTS operator. As such, the condition specific definitions included in the next steps document drafting, in conditions such as Standard Special Condition A12, have been removed; and
- ◆ as discussed earlier in his chapter, **“licensee”** is defined to add greater clarity, in the case of Transco, regarding obligations that relate to the NTS business or the RDN business. As such, references to “licensee” in the licence relate specifically to the NTS business or the RDN business, unless stated otherwise in the condition concerned.

4.29. Definitions regarding “NTS exit capacity” and “NTS exit flow flexibility” have been introduced to permit the licence to reflect changes to the offtake arrangements including the proposed charge change obligations and Option 2A revenue flows. Furthermore, a number of modifications have been made to definitions that reference the network code to ensure that the terms referenced are consistent with the proposed drafting of the UNC. It should be noted that whilst Ofgem has endeavoured to maintain consistency with the terms and definitions that will be included within the UNC at the time of preparing and publishing this document, Transco’s UNC is not as yet fully developed. Ofgem will be consulting further on the arrangements within the UNC. Should there be any inconsistencies between the licence and the UNC, it is Ofgem’s intention to

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<sup>30</sup> It is noted that reference to a direction is required to reflect the fact that all licensees will have paragraphs 1 to 4 and 8 of Standard Special Condition D1 operative within their licence.

correct these as part of a further section 23 licence modification process that will be undertaken following hive-down and prior to any share sale.

4.30. Existing definitions have been modified to reflect necessary cross-reference changes. More substantial modifications to existing definitions include, but are not limited to, the following:

- ◆ “appropriate auditors” has been amended consistent with licence drafting associated with the DPCR licence consultation;
- ◆ “domestic premises” has been moved into Standard Special Condition A3 and sub-paragraph (a) has been removed as it had time-expired post January 1 2002;
- ◆ definitions of “investment grade” and “issuer credit rating” have replaced the definition of “investment grade issuer credit rating” to reflect the changes made as part of the DPCR licence consultation and, as such, to retain consistency between the gas and electricity network business licences as far as is appropriate;
- ◆ “metering equipment” has been modified to ensure that the reference to Transco’s Network Code, at a particular point in the past, refer back to Amended Standard Condition 9 for clarity; and
- ◆ “network code” remains largely the same, with a slight adjustment to reflect that it has been prepared “by or on behalf of” the licensee for the reasons outlined above.

4.31. Further clarification of key definitions has also been undertaken to reflect the separation between Transco’s NTS and RDN businesses and the DTI’s proposed exemption:

- ◆ the definition of “transportation arrangements” has been revised to incorporate relevant gas transporters and clarify, for Transco, whether references are to the NTS or RDN business;
- ◆ the definition of “transportation system” has been amended to clarify this term in relation to the NTS and RDN businesses by use of the phrase “the facilities to which this licence relates”; and



- ◆ the definition of “transportation business” has also been rationalised following consideration of respondents’ views that the multiple definitions within the current licence (which has two definitions - one in lower case and one in upper case, in addition to a separate definition for “transportation and LNG Storage business”) were confusing.
- 4.32. The definition of “supply of transportation services” has been modified to ensure consistency with the prohibited procurement provisions elsewhere in the licence. However, given the division of roles and responsibilities between the NTS and DNs, the definition of “supply of transportation services” is necessarily different between NTS and DN licensees. As a result, it has been necessary to create NTS Special Condition C1A (NTS definition of supply of transportation services) to amend the definition of “supply of transportation services” such that it is applicable to the NTS and reflects the fact that the NTS performs “balancing management”
- 4.33. In clarifying the drafting of Standard Special Condition A3, Ofgem has also addressed issues associated with capitalisation of definitions and has made it clear that:
- ◆ cross-references to standard conditions in the licence should be to the replacement standard special condition or special condition if that standard condition has been switched off; and
  - ◆ that references to the consent or approval of the Authority throughout the licence, that such consent or approval may be subject to conditions that the Authority may specify.
- 4.34. The LNG Storage related provisions of Amended Standard Condition 1 have been placed in paragraph 1 of NTS Special Condition C1 (Amendments to Standard Special Conditions relating to LNG). This NTS special condition augments the provisions of Standard Special Condition A3.
- 4.35. Ofgem therefore proposes to revert Amended Standard Condition 1 to the designated Standard Condition 1, and introduce a new standard special condition applicable to all NTS and DN-GTs. The drafting for Standard Condition 1 and modifications to Standard Special Condition A3 is provided for

comment in Appendices 7 and 8A respectively. Furthermore, the drafting of Special Conditions C1 and C1 A is provided, in Appendix 8C, for comment.

- 4.36. Ofgem invites respondents' views on its proposals for Amended Standard Condition 1. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 2 – Application of Section C (transportation services obligations)***

### **Description**

- 4.37. This standard condition establishes the circumstances under which Section C of the standard conditions of a GT licence will have effect, either in whole or in part, with the consent of the relevant licence holder.

### **Next Steps document**

- 4.38. In the next steps document, Ofgem stated that it continued to consider that Standard Condition 2 should remain in all GT licences including those of NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.39. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.40. One potential purchaser agreed that this condition should apply to all GT licensees and considered that there should be a switch mechanism in relation to it.

### *Shippers/suppliers*

- 4.41. No shippers/suppliers provided a detailed response to this licence conditions within their formal response to the next steps document.

### *DISG comments*

- 4.42. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.43. Ofgem continues to believe that Standard Condition 2 should remain in all GT licences including those of NTS and DN-GTs. The drafting for this condition is provided in Appendix 7.
- 4.44. Ofgem invites respondents' views on its proposals for Standard Condition 2. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 3. Payments by the Licensee to the Authority***

### **Description**

- 4.45. Standard Condition 3 sets out the obligation on the licensee to pay to the Authority an amount determined in accordance with this condition. It prescribes the relevant proportion of the costs of the Authority, Consumer Council, Competition Commission and Secretary of State that are attributable to the licensee and are therefore payable by it.

## **Next Steps document**

- 4.46. In the next steps document, Ofgem stated that it continued to believe that no changes to Standard Condition 3 were necessary as part of the DN Sales process and that the condition should apply to all GTs including NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.47. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

### *Potential Purchasers*

- 4.48. One potential purchaser agreed with the application and drafting of this condition but noted that changes might be introduced following further consideration of the roles of DTI and Ofgem regarding appeals against regulatory decisions.

### *Shippers/suppliers*

- 4.49. No shippers/suppliers provided a detailed response to this licence conditions within their formal response to the next steps document.

### *DISG comments*

- 4.50. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

## **Ofgem's proposals**

- 4.51. Ofgem continues to believe that it will not be necessary to make any changes to Standard Condition 3 as part of the DN sales process to protect the interests of customers in a divested industry structure. Ofgem will be consulting on the licence fee cost recovery principles within the 1<sup>st</sup> quarter of this year. The condition should therefore apply to all GTs including NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.

- 4.52. Ofgem invites respondents' views on its proposals for Standard Condition 3. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 4 – Charging Gas Shippers - General***

### **Description**

- 4.53. Amended Standard Condition 4 contains a requirement for the licensee to provide the Authority with charging statements. The condition also requires that the licensee must use all reasonable endeavours to provide at least 150 days' notice to the Authority, in the event of a proposed change to the transportation charges. It also contains obligations relating to the charging for LNG Storage arrangements.

### **Next Steps document**

- 4.54. As set out in Chapter 3, in the next steps document, Ofgem stated that it considered that the reasonable endeavours obligation, relating to frequency of changes to charges a charge change window apply to both NTS and DN-GTs, particularly in view of the decision to implement Option 2A of the offtake arrangements.
- 4.55. Ofgem accepted that the reasonable endeavours obligation would be subordinate to the best endeavours obligation not to exceed allowed revenue. Furthermore, Ofgem stated that it continued to believe that it would be appropriate for the Joint Office to administer the proposals to change these charges.
- 4.56. Ofgem therefore proposed that the provisions contained within Amended Standard Condition 4 (other than those relating to LNG Storage) would be replicated in Standard Special Condition A4. In addition, it was proposed that

Standard Special Condition A4 would contain the following provisions, which would be applicable to NTS and DN-GTs:

- ◆ the licensee shall use its reasonable endeavours not to make any changes to charges or reserve prices governed by this condition more frequently than **twice** in a formula year;
- ◆ the licensee shall use its reasonable endeavours only to make changes to charges or reserve prices governed by this condition on 1 April and 1 October in each formula year; and
- ◆ the licensee shall comply with the Joint Office Arrangements for the administration of any proposals.

4.57. To address the issue of LNG Storage, Ofgem further proposed that:

- ◆ Standard Special Condition A4 should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS special condition should be introduced to “augment” this standard special condition with LNG related provisions (Special Condition C1, paragraph 2).

### **Respondents’ views**

4.58. In this section, we summarise some of the key views expressed by respondents with respect to transportation charging, and specifically, the frequency and timing of changes to charges. Views expressed on dead-bands with respect to revenue recovery are discussed in Chapter 3. The high level views expressed in this chapter include;

- ◆ NGT considered that it is appropriate to introduce a dead-band around the allowed revenue level for the NTS licence, to which a standard interest rate would apply, of 5% for the NTS SO and 2% for the NTS TO;
- ◆ all three potential purchasers supported the introduction of a dead-band within which a standard interest rate would apply; and

- ◆ two shipper/suppliers supported the inclusion of a dead-band if this would prevent more frequent and uncoordinated changes to charges being implemented.

*NGT*

4.59. As discussed in Chapter 3, NGT noted the following additional comments in respect of transportation charging arrangements:

- ◆ its support for the proposed role of the Joint Office to administer changes to transportation charges and charging methodologies for all DNs and the NTS;
- ◆ it is appropriate to place a reasonable endeavours obligation, to limit DNs to a maximum of two changes to administered charges per year on 1 April and 1 October, noting that this obligation would be subordinate to the best endeavours obligation not to over-recover;
- ◆ the NTS should not be restricted to twice yearly changes or changes on specified dates;
- ◆ it is unnecessary to place equal charging restrictions on non-administered prices e.g. auction reserve prices. The network code sets out clearly the auction and reserve price timings and processes and there is potential for timing mismatch and less efficient reserve price setting if reserve prices are restricted. Furthermore, if reserve prices are to be included in the reasonable endeavours obligation then a transitional arrangement would be required in order to enable NGT to introduce exit reserve prices after hive-down for the first auction in September 2005; and
- ◆ that the ability to make a 1 May change should be retained for LNG constrained credits.

4.60. Furthermore, as discussed in further detail in Chapter 3, NGT stated that restricting the number of changes in charges would increase the likelihood of the NTS under or over-recovering its regulated income by limiting its ability to manage the process. NGT therefore continued to consider that it was appropriate to introduce a dead-band around the allowed revenue level for the NTS licence,

to which a standard interest rate would apply, of 5% for NTS System Operator (SO) and 2% for the NTS Transportation Owner (TO).

#### *Potential Purchasers*

- 4.61. With regard to the frequency of changes to charges and charging methodologies for the NTS and DNs, two potential purchasers considered that permitting changes to charges twice a year would be appropriate. Another potential purchaser highlighted that no restrictions apply in relation to the frequency of modifying electricity distribution charges and suggested that there is no evidence that this has created problems in relation to the operation of the electricity market.
- 4.62. One potential purchaser requested more clarity regarding the interpretation of the reasonable endeavours term in this condition, providing that such detail did not, in effect, change the best endeavours requirement with respect to revenue recovery. This potential purchaser noted that further changes may emerge in future, but provisionally accepted the drafting of Standard Special Condition A4.
- 4.63. Two potential purchasers agreed that the role of the Joint Office should be administrative. One of these purchasers suggested amending the drafting to ensure that the obligation to comply with the Joint Governance Arrangements (JGA) for the administration of any charging proposals would not restrict or prevent the licensee from making changes to its charges.
- 4.64. Another potential purchaser suggested that the paragraph dealing with the JGA should be reworded to reflect the fact that the role of the Joint Office would be limited to the “co-ordination” of administration.
- 4.65. One potential purchaser suggested removing reference to designated storage from this and other relevant licence conditions.
- 4.66. Another potential purchaser suggested that the words “on 1 April and 1 October” read “with effect from” in case any changes are to be made at a later date with retrospective effect.
- 4.67. All three potential purchasers supported the proposal to introduce a dead-band within which a standard interest rate would apply. One of these potential purchasers suggested that the proposed dead-bands appear to be a reasonable



risk mitigation device if charges cannot be changed more than twice a year. Another potential purchaser suggested that this would be in line with NGC's electricity transmission licence and also reflect the electricity distribution network arrangements. This potential purchaser suggested that a 2% dead-band would be appropriate to apply to both the NTS and the DNs. The other potential purchaser agreed with Transco's suggestion of 2% limit in relation to DN licensees.

#### *Shippers/suppliers*

- 4.68. Comments provided by shippers/suppliers in relation to proposals for transportation charging arrangements are summarised in Chapter 3.
- 4.69. With regard to the frequency of changes to charges and charging methodologies for the NTS and DNs, four shippers/suppliers supported the proposal to only allow changes once a year (aligned to annual contracting rounds in October). Of these, one shippers/supplier considered that the current 150 days notice period should remain in place.
- 4.70. Two further shippers/suppliers were supportive of the proposal for two fixed points (in April and October) for introducing revisions and considered that all relevant transporters should work to this timeline to minimise complexity to users and consumers alike. Of these, one shipper/supplier welcomed Ofgem's recognition that any deviation from a generic approach should be subject to a cost benefit analysis which would need to consider the cost implications of such variation on shippers and suppliers. The other shipper/supplier suggested that if changes were required, outside of the specified parameters, the GTs should be obliged to consult affected parties on the proposed changes, advise them of the consequences of not making the proposed changes and secure Authority approval for the deviation.
- 4.71. Two shippers supported the inclusion of a dead-band if this would prevent more frequent and uncoordinated charge changes being implemented by DN-GTs.

#### *DISG comments*

- 4.72. The licence condition drafting for Standard Special Condition A4 has been discussed at a number of DISG meetings since publication of the next steps

document (DISG 29, DISG 32 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

- 4.73. At the DISG, interested parties were informed by Transco of its plans for a consultation on its NTS charging methodology which will, amongst other things, consider whether TO and/or SO commodity charges should be passed through to shippers via the DNs or levied directly on shippers.
- 4.74. At the DISG, Ofgem explained that it was necessary for it to make an assumption regarding revenue flows between NTS and DN-GTs as the outcome of NGT's pricing consultation would not be known prior to the publication of Ofgem's licence document. For the purposes of this consultation Ofgem has assumed that NTS charges relating to exit flow flexibility and exit capacity would be passed through to the DNs and that NTS commodity charges would be levied directly by the NTS onto shippers. At DISG Ofgem explained that it may be necessary to revisit the proposals in this licence condition when the outcome of NGT's pricing consultation is known. Ofgem therefore modified its proposals following publication of the next steps document and at DISG presented new proposals such that:
- ◆ the GT will be obliged to use reasonable endeavours to make changes to charges for flow flexibility and exit capacity once per year (on 1 October);
  - ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to all other transportation charges twice a year (1 October and 1 April);
  - ◆ DN-GTs will be obliged to use reasonable endeavours to make changes to transportation charges once per year (on 1 October).
- 4.75. Furthermore, at DISG, Ofgem stated that in the event that changes to charges did not meet these reasonable endeavours obligations, the licensee should inform the Authority in writing stating the reasons for the required changes. Ofgem also informed DISG members that in these circumstances, the Authority would make public any non-confidential information provided by the licensee.

- 4.76. Ofgem presented its revised drafting at DISG including an NTS special condition to augment to allow the NTS to change its charges twice a year and a DN standard special condition to augment for the DNs to allow them to make changes once a year. Ofgem invited DISG members to provide their views on this revised licence drafting.
- 4.77. A number of comments were made by various attendees in, and subsequent to, the DISG meetings:
- ◆ NGT expressed concern over restrictions on setting auction prices, and considered that the current drafting would lead to a time delay between the determination and application of auction prices that would reduce the cost-reflectiveness of charges;
  - ◆ NGT expressed a further concern that tying changes to particular dates may be counter-productive given that the auction timetable is not yet agreed for the exit regime, and that (for entry and exit) it will be subject to change at any time via the UNC modification process;
  - ◆ NGT sought clarification on what is meant by “changes to take place on 1 October” in respect of changes to auction reserve prices;
  - ◆ One potential purchaser stated that it would be appropriate to align the gas DN notice period with the electricity notice period. This potential purchaser was also concerned that the proposed "once a year" restriction, together with the 150 day notice requirement and the purchase timetable, would, in effect, mean that DN purchasers would not be able to change their charges until October 2006;
  - ◆ One shipper/supplier stated that the advance notice of the charge changes would allow shippers/suppliers stability when striking contracts;
  - ◆ One shipper/supplier asked whether there would be a separation charging methodology for the RDNs; and
  - ◆ One shipper/supplier detailed that there can be further implications when it is not simply the size of the charge that changes but where the type of charge levied is amended.

## **Ofgem's proposals**

- 4.78. The charge change window obligation has been introduced in response to shipper and customer group concerns. Ofgem notes that similar arrangements are not in place in the electricity industry, but that the starting point in gas and electricity is also different. For example, in gas, Transco has historically been responsible for all changes to charges across the transmission and distribution networks. Shippers and customers have requested common arrangements across all networks. Ofgem has taken these views into account and does not believe that it is appropriate for such common arrangements to be implemented. Ofgem understands the concerns raised by shippers and customers and believes that there is a need for coordination in charges which is why Ofgem is proposing that the charge changes are coordinated by the Joint Office.
- 4.79. Ofgem notes that this is a key issue for shippers and considers it to be appropriate for a reasonable endeavours obligation to apply to both NTS and DN-GTs, including changes to auction reserve prices at future auctions. Ofgem considers that a reasonable endeavours obligation would give the NTS sufficient flexibility to change its charges following events such as the introduction of a new terminal. This certainty, with respect to auction reserve prices, would be beneficial to shippers and customers and therefore, Ofgem believes that this should be encouraged. Ofgem does not consider that "with effect from" the dates specified would add the necessary clarity, as this would allow retrospective adjustments which would not address shipper concerns regarding their ability to plan ahead and implement changes at a single point.
- 4.80. Furthermore, Ofgem proposes that in the event that changes to charges do not meet these reasonable endeavours obligations the licensee shall inform the Authority in writing stating the reasons for such a change and the Authority shall make public any non-confidential information provided in this regard (consistent with paragraph 2A).
- 4.81. Ofgem notes that the reasonable endeavours obligation will be subordinate to the best endeavours obligations within the licence with respect to revenue recovery. However, as stated in Chapter 3, Ofgem is not proposing to introduce a dead-band at this time as this will impose costs on customers. Furthermore, the transparency obligation that will be placed upon licensees in the event that

they fail to meet their reasonable endeavours obligation should discourage such changes and allow the situation to be monitored.

- 4.82. Ofgem has considered respondents' views with respect to the notice period required, and has concluded that it remains appropriate to retain the reasonable endeavours obligation for 150 days' notice.
- 4.83. As explained above, following the publication of the next steps document, Ofgem has given further consideration to the likely revenue flows between the NTS, DNs and shippers. For the purpose of this consultation, Ofgem has assumed that only NTS exit capacity and NTS exit flow flexibility related charges will be passed through DNs to shippers.
- 4.84. Given this, and following consideration of respondents' views, Ofgem has modified its proposals such that:
- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to charges for flow flexibility and exit capacity once per year (on 1 October);
  - ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to all other transportation charges twice a year (on 1 October and 1 April); and
  - ◆ DN-GTs will be obliged to use reasonable endeavours to make changes to all transportation charges once per year (on 1 October).
- 4.85. Given that these obligations now differ between the NTS and the DNs, it has been necessary to create two new conditions: an NTS special condition (Special Condition C7) and a standard special condition (Standard Special Condition D11) applicable to all DNs. These conditions are discussed in Chapter 5. The implementation of these conditions will permit the provisions of Standard Special Condition A4 to be amended appropriately to reflect the different obligations between the NTS and DNs.
- 4.86. As noted in Chapter 5, as well as introducing the different charge change obligations:

- ◆ Special Condition C7 reflects the DTI's proposed exemption, by inserting "and/or DN operators as appropriate" in paragraph 1(a); and
  - ◆ Standard Special Condition D11 clarifies that the provisions of Standard Special Condition A4 are applicable to each distribution network within Transco's RDN business.
- 4.87. The impact of the DTI's proposed exemption is also reflected in the change of the name of this condition from "Charging Gas Shippers – General" to "Charging – General".
- 4.88. Furthermore, as discussed in Chapter 3, with respect to storage provisions, Ofgem has decided that the designated wording for storage provisions should not be included within standard special conditions. As such, paragraphs 6, 7, 9 and 10 are "not used" but are augmented for LNG Storage provisions by paragraph 2 of NTS Special Condition C1.
- 4.89. Ofgem therefore proposes that the provisions of Amended Standard Condition 4, subject to the modifications above, be placed in Standard Special Condition A4 (Charging – General) applicable to all NTS and DN-GTs. Ofgem also proposes that Standard Special Condition D11 should augment this condition with respect to all DN-GTs, and that Special Condition C7 should augment the condition applicable to the NTS licensee. The revised drafting for these conditions are provided for comment in Appendices 8A, 8D & 8C respectively. As such, Amended Standard Condition 4 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.90. Ofgem invites respondents' views on its proposals for Amended Standard Condition 4. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## **Related consultation**

- 4.91. Ofgem would note that further modification of this condition may be required should the outcome of Transco's proposed pricing consultation result in additional charges being passed through DNs from the NTS to shippers. Should such changes be required, these will be made as part of a section 23 licence modification process subsequent to hive-down.

## ***Amended Standard Condition 4A – Obligations as Regard Charging Methodology***

### **Description**

- 4.92. This amended standard condition describes the objectives of a charging methodology and sets out that the transporter should, from time to time, make modifications to facilitate the achievement of these objectives.

### **Next Steps document**

- 4.93. In the next steps document, Ofgem stated that, following consideration of respondents' views and to accommodate the decision to implement Option 2A for offtake arrangements, the reasonable endeavours obligation should be changed such that it would require licensees to use reasonable endeavours to announce and implement changes to the methodologies on two specified dates in the year. Ofgem considered that it would be appropriate to repeat the restriction on frequency of changes obligation in respect of the methodology to ensure further protection for shippers in relation to the number of methodology changes. Ofgem was also of the opinion that this would ensure that methodology changes between GTs would be conducted at the same times in the year to enable the proposals to be administered effectively by the Joint Office and mitigate the shippers' costs of scrutinising these proposals.
- 4.94. Ofgem considered that it would be appropriate for the licensee to be required to use the Joint Office to administer the process for consultation on changes to the charging methodologies to ensure that changes would be widely consulted on. Ofgem also believed that this would ensure consistency of the consultation

process with other DN and/or NTS-GTs who were in the process of consulting on changes to methodologies.

- 4.95. Ofgem considered it appropriate that the licensee would be required to keep the charging methodology at all times under review for the purposes of meeting the relevant objectives. Ofgem was concerned that the words to achieve “coordination, consistency and best practice” could imply co-ordination between GTs in relation to the content of the charging methodologies and the achievement of the relevant objectives, which would be inappropriate.
- 4.96. Ofgem noted a point raised by NGT regarding the differences in the test for the making of modifications to the electricity charging methodologies and gas charging methodologies (i.e. the *better achievement* of the relevant objectives in electricity as opposed to the *achievement* of the relevant objectives in gas). Ofgem proposed that the current wording within Transco’s licence was retained, but invited respondents’ views on this issue.
- 4.97. Ofgem further considered that it would not be best regulatory practice to seek to extend the reasonable endeavours obligations relating to the frequency of changes to charges and/or charging methodologies to the IGTs through the DN sales process.
- 4.98. In view of the scope of changes to this condition, Ofgem proposed that Standard Special Condition A5 should be introduced into the licences of all NTS and DN-GTs containing the provisions of the condition including the changes outlined in Ofgem’s proposals. Ofgem therefore proposed that Amended Standard Condition 4A should revert to the designated standard condition in the licences of all DN and NTS-GTs and will be switched off in these licences.
- 4.99. To address the issue of LNG Storage, Ofgem further proposed that:
- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
  - ◆ a new NTS special condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 3).



## **Respondents' views**

- 4.100. As set out in Chapter 3 and with respect to Amended Standard Condition 4 above, respondents had a number of comments on transportation charging arrangements. Specific comments on Amended Standard Condition 4A are discussed below.

### *NGT*

- 4.101. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

### *Potential Purchasers*

- 4.102. Three potential purchasers considered that it is not appropriate to introduce an obligation that requires the licensee to keep the charging methodology under review at all times and that it would be more appropriate to require a review at least annually. One potential purchaser suggested that the words “on 1 April and 1 October” read “with effect from” in case any changes are made at a later date with retrospective effect.
- 4.103. Another potential purchaser suggested that, in circumstances where the licensee has more than one DN, the obligations associated with this condition should be in respect of each DN. This purchaser believed that it would be necessary to ensure that the obligation to comply with the Joint Office Arrangements for the administration of any changes to the charging methodology would not restrict or prevent the licensee from making changes to its methodology. This potential purchaser was of the opinion that the Joint Office should purely deal with the administration of the process. Therefore, it stated that the drafting of paragraph 2(b) should be amended so that it would start with “without prejudice to the licensee’s wider obligations”.
- 4.104. Another potential purchaser requested clarification of the term “the gas shippers” and asked whether the insertion of this is intended to require that a licensee should consult its own shippers on changes or if it would be required to consult with all gas shippers.

### *Shippers/suppliers*

- 4.105. One shipper/supplier suggested that licensees should have a reasonable endeavours obligation to limit changes to charging methodologies to no more than two per annum, with a minimum notice period of six months prior to these changes. Another shipper/supplier suggested that licensees should have a reasonable endeavours obligation to limit changes to charging methodologies to no more than one per annum, and to keep the charging methodology simply “under review” (as opposed to “under review at all times”).
- 4.106. One shipper/supplier asked for clarification regarding the definition of the term “relevant methodology objectives”.

### *DISG comments*

- 4.107. The licence condition drafting for Standard Special Condition A5 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and through written responses after these meetings. The minutes of these meetings are attached for information at Appendix 2.
- 4.108. AT DISG 32, a potential purchaser reiterated their concern with the use of the phrase “at all times under review” in the context of charging methodologies.
- 4.109. At DISG 32, Ofgem raised the issue of independent systems, which the DTI has assumed responsibility for addressing, consistent with the statements made by Ofgem in the next steps document relating to Special Condition 18. The proposed treatment of these independent systems is discussed in greater detail in Chapter 3. Ofgem noted, at DISG 32 that, the determination of “alternative arrangements” by the DTI on the basis on which the customers connected to such networks would be charged, may require consequential licence amendments. Some suggested amendments to Standard Special Condition A5 were presented for comment at DISG 33. This prompted the following comments from DISG members:

- ◆ One potential purchaser suggested the addition of “or (d)” after (aa) in Paragraph 5 (a) of Standard Special Condition A5, as cost reflective pricing will not be in place on independent systems; and
- ◆ Another potential purchaser was concerned about the uncertainty surrounding the proposed future arrangements in respect of the independent systems/undertakings. In particular, they did not understand how a Direction given by the Secretary of State under proposed Standard Special Condition A27 might be governed or changed. Notwithstanding this concern, they did not object to the proposed drafting that would require the charging methodology to reflect these alternative arrangements.

### **Ofgem’s proposals**

- 4.110. Ofgem notes that this is a key issue for shipper/suppliers and having considered respondents’ views, Ofgem continues to consider that it would be appropriate for a reasonable endeavours obligation to apply to both NTS and DN-GTs. Ofgem does not believe that the insertion of a reference to the date from the condition would “come into effect” would add the necessary clarity, and that retrospective adjustments would not address shipper concerns regarding their ability to plan ahead and implement changes at a single point.
- 4.111. Ofgem has considered respondents’ views with respect to keeping charging methodologies “at all time under review”. However, Ofgem remains of the view that this obligation is appropriate, especially in view of its consistency with National Grid Company’s (NGC’s) licence. Ofgem believes that compliance with all licence obligations, is on-going, and as a result, it is appropriate for the charging methodologies to be reviewed on an ongoing basis in this regard.
- 4.112. The charging obligations consulted upon within the next steps document, as represented by Standard Special Condition A4 and Standard Special Condition A5, were drafted on the assumption that charge change provisions would be common across NTS and DN-GTs with changes to charges permitted on a twice yearly basis.
- 4.113. However, following publication of the next steps document, Ofgem’s understanding of the revenue flows between the NTS, the DNs and shippers has

changed. As a result, Ofgem has decided, on the assumption that only NTS exit capacity and NTS exit flow flexibility related charges will be passed through DNs to shippers, that it is no longer appropriate for these charge change obligations to be common.

4.114. Given this, and following consideration of respondents' views, Ofgem has modified its proposals such that:

- ◆ the NTS will be obliged to use reasonable endeavours to make changes to its charging methodology for flow flexibility and exit capacity **once** per year (on 1 October);
- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to its charging methodology for all other transportation charges **twice** a year (1 October and 1 April); and
- ◆ DN-GTs will be obliged to use reasonable endeavours to make changes to the charging methodology for all transportation charges **once** per year (on 1 October).

4.115. Given that these obligations now differ between the NTS and the DNs, it has been necessary to create two new conditions: an NTS special condition (Special Condition C7) and a standard special condition (Standard Special Condition D11) applicable to all DNs. These conditions are discussed in Chapter 5. As such, the provisions of Standard Special Condition A5 can be amended appropriately to reflect the difference between the NTS and DNs as appropriate.

4.116. As noted in Chapter 5, as well as introducing the different charge change obligations:

- ◆ Special Condition C7 reflects the DTI's proposed exemption, by inserting "and / or DN operators as appropriate" in paragraph 2 (and clarifying the circumstances under which it would be appropriate to consult DN operators); and
- ◆ Standard Special Condition D11 clarifies that the provisions of Standard Special Condition A5 are applicable to each distribution network within Transco's RDN business.

- 4.117. Furthermore, as discussed in Chapter 3, with respect to storage provisions, Ofgem has reached the decision that the designated wording for storage provisions should not be included within standard special conditions. As such, the storage provisions within paragraphs 11 and 12 have been removed, and these paragraphs are augmented for LNG Storage provisions by paragraph 3 of NTS Special Condition C1.
- 4.118. As noted above, modifications have also been proposed in relation to Standard Special Condition A5 to reflect the fact that the “alternative arrangements”<sup>31</sup> for charging customers connected to independent systems, as determined by the DTI, require recognition that charging methodologies will need to reflect such arrangements. As a result, modifications are proposed to paragraphs 2 and 5 following consideration of respondents’ views in this regard.
- 4.119. Ofgem proposes that the provisions of Amended Standard Condition 4A be placed, subject to the modifications above, in Standard Special Condition A5, applicable to all NTS and DN-GTs, Standard Special Condition D11, applicable to all DN-GTs, and in Special Condition C7, applicable to the NTS licensee. The revised drafting for these conditions is provided for comment in Appendices 8A, 8D & 8C respectively. It is proposed that Amended Standard Condition 5 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.120. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 4A. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

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<sup>31</sup> The proposed alternative arrangements can be found at:  
[http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

## **Related consultation**

- 4.121. Ofgem would note that further modification of this condition may be required should the outcome of Transco's proposed pricing consultation result in further charges being passed through DNs from the NTS to shippers. Should such changes be required, these will be made as part of a section 23 licence modification process subsequent to hive-down.

## ***Standard Condition 4B – Connection Charges etc***

### **Description**

- 4.122. This condition permits the relevant transporter, in relation to the connection of premises to the main, to charge the person whose premises are being connected for the costs of supplying and laying the pipe.

### **Next Steps document**

- 4.123. In the next steps document Ofgem stated that, having considered respondents' views, it was proposing not to make any changes to this condition and that this condition would therefore apply to all GTs including DN and NTS-GT licence holders.

### **Respondents' views**

#### *NGT*

- 4.124. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.125. One potential purchaser agreed that this condition should apply to DN licensees, and accepted the application and the drafting of the licence condition.

#### *Shippers/suppliers*

- 4.126. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.127. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.128. Having considered respondents' views, Ofgem continues to propose that Standard Condition 4B should remain unchanged. This condition will therefore apply to all GTs including DN and NTS-GT licence holders. The drafting for this condition is provided for comment in Appendix 7.
- 4.129. Ofgem invites respondents' views on its proposals for Standard Condition 4B. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 4C – Charging of Gas Shippers – Supplemental Connection Charges***

### **Description**

- 4.130. Standard Condition 4C permits the licensee to include "supplementary charges" in its charges for the conveyance of gas to premises in areas designated by the Authority which have not previously been supplied by gas or are not within 23 metres of a relevant main. This condition is expressly time limited in application (applications for designation had to be received by 31 December 2003).

### **Next Steps document**

- 4.131. In the next steps document Ofgem acknowledged that its proposals regarding Standard Condition 4C did not directly relate to DN sales. However, Ofgem stated that it believed that it would be desirable, as part of the DN sales process,

to remove time expired conditions in order to give clarity to licensees (particularly any new purchasers of DNs) as to the obligations within their licence. Ofgem therefore proposed to switch off this condition and in the licences of other GTs at a suitable opportunity.

### **Respondents' views**

#### *NGT*

- 4.132. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.133. One potential purchaser agreed that this condition should be switched off. However, this purchaser suggested that such tidying up should only be used for things such as redundant conditions and not more generally to effect other changes that should be pursued outside of the sale process.

#### *Shippers/suppliers*

- 4.134. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.135. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.136. Ofgem continues to believe that it would be desirable, as part of the DN sales process, to remove time expired conditions in order to give clarity to licensees (particularly any new purchasers of DNs) as to the obligations within their licence.
- 4.137. Ofgem therefore proposes to switch off this condition. Ofgem intends to switch this condition off in the licences of other GTs at a suitable opportunity.



Furthermore, cross-references to Standard Condition 4C throughout the licence have been removed.

4.138. The drafting for this condition is provided for comment in Appendix 7.

4.139. Ofgem invites respondents' views on its proposals for Standard Condition 4C. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 4D – Conduct of Transportation Business***

### **Description**

4.140. This condition obliges the licensee to conduct its transportation business to ensure that neither it, nor any affiliate or related undertaking, or any gas shipper or supplier receives any unfair commercial advantage including any such advantage from a preferential or discriminatory arrangement. The definition of transportation business within this condition includes LNG storage, metering services and meter reading services.

### **Next Steps document**

4.141. In the next steps document Ofgem proposed that Amended Standard Condition 4D should be replaced by Standard Special Condition A6 which would apply to the NTS and DN-GTs.

4.142. Ofgem also stated that, having considered respondents' views as well as the views of DISG members, it was of the opinion that it would be appropriate for the provisions relating to metering services and meter reading services to apply both to the NTS and DN-GTs.

4.143. Ofgem set out that this condition would also be augmented by NTS Special Condition C18 (Conduct of the Transportation Business in respect of the NTS) to prevent the NTS from conferring unfair commercial advantages on its RDNs.

4.144. To address the issue of LNG, Ofgem further proposed that:

- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS special condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 4).

4.145. Ofgem noted concerns expressed by DISG members, representing IGTs, in relation to the potential competition issues between any NTS or DN-GTs also owning, within the same group, an IGT business. Ofgem considered that the provisions already contained within the proposed Standard Special Condition A6, together with Ofgem's wider competition powers, would be sufficient to address such concerns.

4.146. Ofgem stated that it had not identified the need for any further modifications within this condition to address competition concerns associated with potential purchasers owning both competitive and monopoly activities within the same group.

### **Respondents' views**

#### *NGT*

4.147. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

4.148. One potential purchaser accepted the need for appropriate provisions relating to affiliates and suggested changes to the wording in Standard Special Condition A6, for example to deal with the fact that it is proposed not to place the NTS and

RDN businesses into separate entities so that the licence conditions do not inadvertently capture other licensees not perceived to pose the same problem.

- 4.149. Another potential purchaser supported the proposal to augment this condition with NTS Special Condition C18 to prevent the NTS from conferring unfair commercial advantages on its RDNs. This purchaser agreed with Ofgem that the provisions in this condition would be sufficient to address any concerns that the NTS or DN-GTs may confer an unfair advantage on an affiliate.

#### *Shippers/suppliers*

- 4.150. One shipper/supplier was of the view that paragraph 1 of this condition should be amended by the inclusion of unrelated GTs as sub-paragraph (c), to ensure GTs do not discriminate in favour of other GTs.
- 4.151. Another shipper/supplier suggested that in paragraph 2(i) – “Provision of Metering Services” and “Meter Reading Services” be shown as a separate facet of “transportation business” as the implication of the current drafting is that only metering that is related to storage is covered, as point (d) is itself a sub point of 2(i).

#### *DISG comments*

- 4.152. The licence condition drafting for Standard Special Condition A6 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 30 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.

### **Ofgem’s proposals**

- 4.153. Ofgem continues to believe that it is appropriate for this licence condition to be applicable to both NTS and DN-GTs licences. Following consideration of respondents’ views with respect to Standard Special Condition A6, and following discussions at DISG, Ofgem has decided that it would be more appropriate to provide the necessary clarification with respect to the business separation of Transco’s NTS and RDN businesses within paragraph 1(a) of Standard Special Condition A6. As such, Special Condition C18, which Ofgem proposed to

implement to address issues regarding the conduct of the RDNs in relation to the NTS, is no longer proposed. This change in Ofgem's proposals is also discussed in Chapter 6.

4.154. Ofgem has further amended this licence condition so that it is clear that when referring to licensee and any affiliated or related undertaking this may also include any other relevant gas transporter which may be within the same legal entity. This is to ensure that this condition captures any discrimination between Transco's network businesses. Additional amendments have been made to this licence condition to ensure that it is clear that a DN operator, who has entered into transportation arrangements with other relevant gas transporters, shall not obtain any unfair commercial advantage.

4.155. Following consideration of respondents' views, the drafting of Standard Special Condition A6 has also been subject to a number of modifications including, but not limited to, the following:

- ◆ clarification of paragraph 1(a) to clarify that the NTS business cannot confer any unfair commercial advantage upon the RDN business and vice versa;
- ◆ insertion of a paragraph 1(c) to set out that the licensee cannot confer any unfair commercial advantage upon any DN operator who has entered into transportation arrangements under the terms of the DTI's proposed exemption; and
- ◆ removal of the designated storage wording (in paragraphs 2 and 3), consistent with Ofgem's proposed treatment of storage provisions as discussed in Chapter 3, with these paragraphs augmented for LNG Storage provisions by paragraph 4 of NTS Special Condition C1.

4.156. Ofgem therefore proposes that the provisions of Amended Standard Condition 4D be placed in Standard Special Condition A6 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 4D will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.

- 4.157. Ofgem invites respondents' views on its proposals for Amended Standard Condition 4D. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Amended Standard Condition 4E – Requirement to Enter into Transportation Arrangements in Conformity with the Network Code***

#### **Description**

- 4.158. This condition requires the licensee to enter into transportation arrangements that conform with the relevant provisions of the Network Code, unless the Authority accepts otherwise. For the purposes of this condition transportation arrangements include LNG Storage arrangements. This condition also includes an obligation on the licensee concerning information disclosure.

#### **Next Steps document**

- 4.159. In the next steps document Ofgem stated that, as it had concluded that there would be no need for a separate offtake code, limited changes would be required to this condition.
- 4.160. Ofgem considered that amendments to Standard Condition 4E, in Transco's existing GT licences, relating to information disclosure should apply to both NTS and DN-GTs. Ofgem therefore proposed that Standard Special Condition A7 should be introduced within all NTS and DN-GT licences.
- 4.161. To address the issue of LNG, Ofgem further proposed that:
- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and

- ◆ a new NTS Special Condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 5).

### **Respondents' views**

#### *NGT*

- 4.162. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchasers*

- 4.163. One potential purchaser accepted the drafting proposed for Standard Special Condition A7 and the assumed reversion of Amended Standard Condition 4E to a standard condition that is then switched off.

#### *Shippers/suppliers*

- 4.164. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document

#### *DISG comments*

- 4.165. The licence condition drafting for Standard Special Condition A7 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.

### **Ofgem's proposals**

- 4.166. Following consideration of respondents' views, the drafting of Standard Special Condition A7 has been subject to a number of modifications including, but not limited to, the removal of the designated storage wording (in paragraphs 2 and 3), consistent with Ofgem's proposed treatment of storage provisions as discussed in Chapter 3. These paragraphs will also be augmented, in respect of LNG Storage provisions, by paragraph 5 of NTS Special Condition C1.

- 4.167. Ofgem therefore proposes that the provisions of Amended Standard Condition 4E be placed in Standard Special Condition A7 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 4E will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.168. Ofgem invites respondents' views on its proposals for Amended Standard Condition 4E. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 5 – System Development Obligations***

### **Description**

- 4.169. Standard Condition 5 requires that a licensee applying for an extension of its licence under section 7(4) of the Gas Act must give notice to the HSE and (if required) the designated registrar of pipes.

### **Next Steps document**

- 4.170. In the next steps document Ofgem stated that, following consideration of respondents' views on this condition, Ofgem considered that it would be appropriate for Standard Condition 5 to continue to apply within all GT licences including NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.171. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchasers*

- 4.172. One potential purchaser agreed with the application and drafting of this licence condition.

#### *Shippers/suppliers*

- 4.173. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.174. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.175. Following further consideration of the issues associated with designated register of pipes Ofgem has altered its proposals from the next steps document.
- 4.176. AS discussed at DISG 34, Ofgem considers that it is appropriate for the existing licence conditions (specifically Standard Condition 5A and Standard Condition 33) which refer to the designated registrar of pipes to be amended as part of the DN sales process, to reflect the potential existence of more than one designated registrar of pipes.
- 4.177. At DISG 34, Ofgem therefore proposed that the provisions of Standard Condition 5A and Standard Condition 33 should be moved into standard special conditions applicable to all NTS and DN-GTs.
- 4.178. However, since discussions at DISG 34, it has come to Ofgem's attention that Standard Condition 5 cross-references Standard Condition 5A and, as a result, this standard condition has been switched off, and introduced as a standard special condition. Other than changes to the cross-references and a minor modification to paragraph 1(b) to acknowledge that there may be more than one designated registrar of pipes.



- 4.179. Other consequential changes have been made to the licence in this regard, to ensure that the appropriate definitions have been brought forward from Standard Condition 1 into Standard Special Condition A3.
- 4.180. Ofgem proposes that the provisions of Standard Condition 5, subject to the modifications above, be placed in Standard Special Condition A50 applicable to all NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 8A. Standard Condition 5A will then be switched off.
- 4.181. Ofgem invites respondents' views on its proposals for Standard Condition 5A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Standard Condition 5A – Information to be Provided to the Designated Registrar of Pipes***

#### **Description**

- 4.182. Subject to this condition becoming applicable (by the Authority issuing a direction), this condition describes the information that the licensee is obliged to provide to the designated registrar of pipes within 28 days of commissioning a new main or changing existing data. This condition requires the licensee to give 7 days notice to the registrar of the location of a pipe before it is commissioned.
- 4.183. While this condition is applicable in the present licence, the Authority has not yet issued such a direction, therefore, there is currently no designated registrar of pipes. Presently this obligation is undertaken on a voluntary basis.

#### **Next Steps document**

- 4.184. In the next steps document Ofgem stated that it would not be appropriate to make any changes to this condition and that it should also apply to all GTs including NTS and DN licence holders. Ofgem indicated that it would be

considering within the context of the DN sales project whether to issue a direction, activating the designated registrar of pipes provisions of the licence.

### **Respondents' views**

#### *NGT*

- 4.185. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.186. One potential purchaser agreed with the application and drafting of this licence condition.

#### *Shippers/suppliers*

- 4.187. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.188. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.
- 4.189. Following further consideration of the impact of DN sales upon Transco's existing licences conditions, Ofgem reached the view that both Standard Condition 5A (Information to be Provided to the Designated Registrar of Pipes) and Standard Condition 33 (Designated Registrar of Pipes) were drafted such that they only recognised the possibility of there being one designated registrar of pipes. As a result, Ofgem took revised drafting of these conditions to DISG 34. This drafting acknowledged the possibility of more than one designated registrar of pipes within Standard Special Condition A49 (Designated Registrar of Pipes) and Standard Special Condition A50 (Information to be Provided to a Designated Registrar of Pipes). However, following this DISG meeting, Ofgem is now proposing to switch off Standard Condition 5, and as such, Standard Condition 5 will become Standard Special Condition A50, and Standard Condition 5A will

become Standard Special Condition A51 (Information to be Provided to a Designated Registrar of Pipes).

- 4.190. The licence condition drafting for the standard special condition to replace Standard Condition 5A was discussed at DISG 34. Industry participants have therefore had the opportunity to provide detailed comments on the drafting both conditions during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.
- 4.191. However, whilst NGT expressed concern at DISG 34 regarding the potential for designation of one or more registrars of pipes, Ofgem did not receive any specific comments on the drafting of this condition.

### **Ofgem's proposals**

- 4.192. Following further consideration of the issues associated with designated register of pipes Ofgem has altered its proposals from the next steps document.
- 4.193. Ofgem considers that it is appropriate for the existing licence condition to be amended as part of the DN sales process, to reflect the potential existence of more than one designated registrar of pipes.
- 4.194. Transco has informed Ofgem that the Front Office Management System Agreements (FOMSA) will provide for the continuation of the existing voluntary arrangement to continue in the short term. Ofgem, however, considers it is appropriate for the licence to be amended to reflect change of DN ownership and to enable Ofgem to appoint one or more DNs as designated registrars of pipes, if required.
- 4.195. Ofgem proposes that the provisions of Standard Condition 5A, subject to the modifications above, be placed in Standard Special Condition A51 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 5A will then be switched off.
- 4.196. Ofgem invites respondents' views on its proposals for Standard Condition 5A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the

conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **Related consultations**

- 4.197. The question of whether the Authority would issue a direction, activating the Designated Registrar of Pipes provisions of the licence, would be considered in conjunction with Standard Special Condition A49 (Designated Registrar of Pipes). Ofgem proposes to consult on these issues concerning the designated registrar of pipes in February 2005.

## ***Amended Standard Condition 6 – Emergency Services and Enquiry Service Obligations***

### **Description**

- 4.198. Amended Standard Condition 6 sets out a number of obligations on the licensee with respect to emergency services. These include:

- ◆ **telephone service.** A requirement that the licensee must establish, or procure the establishment of, and operate and maintain a single free of charge, efficiently run, well publicised, continuously manned emergency telephone number, including arrangements for the deaf and blind;
- ◆ **domestic supplies and minor repairs.** A requirement to prevent gas escapes in such a way as to maintain, as far as reasonably practicable, the supply to domestic premises for heating and cooking; and
- ◆ **requirements on personnel.** A requirement for work to be completed by trained persons able to recognise leakage of carbon monoxide who will inform the owner or the occupier of the relevant premises about the carbon monoxide risks.

- 4.199. There is also a statutory obligation on Transco to provide the telephone service.

### **Next Steps document**

- 4.200. In the next steps document Ofgem stated that it agreed with comments raised by respondents who set out that a pre requisite of any DN sales should be an

integrated and consistent response to emergency situations and set out that it intended to ensure that this would be the case. Ofgem also detailed that it would ensure that there was a clear definition of the roles of different GTs in relation to emergencies at DN boundaries, on IGT networks and on the NTS. In addition, Ofgem expressed agreement with a view expressed by a respondent, that the obligations in the licences relating to emergency services should be consistent with requirements of GTs' safety cases and GS(M)R.

- 4.201. Ofgem stated that, in light of its proposals regarding the coordination of emergency services Ofgem did not consider that it would be necessary to increase the scope of Amended Standard Condition 6. Instead, Ofgem proposed that, where appropriate, new licence conditions would be introduced (for example, relating to the provision of emergency services in respect of the NTS).
- 4.202. In respect of comments raised in relation to the 0800 telephone number, Ofgem considered that, consistent with the current arrangements regarding IGTs the provisions of this condition would allow GTs, other than Transco, to discharge their obligations to provide a telephone service contractually via Transco.
- 4.203. Ofgem stated that requirements relating to the advertisement of the 0800 number are generally contained within the safety regulation and that it did not therefore consider that it would be appropriate to duplicate such requirements within the licences of DN and NTS-GTs.
- 4.204. Ofgem therefore believed that it would be appropriate for the provisions contained in this condition to be placed in the licences of all NTS and DN owners as Standard Special Condition A8.
- 4.205. In addition, given the Authority's decision regarding legal separation, Ofgem considered that it may be necessary to make a minor amendment to paragraph 4 of Standard Special Condition A8 to ensure that the requirement for no undue discrimination would only apply between business units of a single company.<sup>32</sup>

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<sup>32</sup> This amendment would be similar to the one proposed in relation to Amended Standard Condition 4E (or Standard Special Condition A6).

## **Respondents' views**

### *NGT*

- 4.206. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.207. One potential purchaser supported the view that, where appropriate, control is exerted through the safety case, there is no need for further reinforcement through a licence condition. This potential purchaser welcomed the fact that IDN obligations regarding the 0800 telephone number would be discharged through a contract with Transco. This potential purchaser agreed with the application and the drafting of Standard Special Condition A8 and the associated reversion of Amended Standard Condition 6 to a standard condition that would then be switched off.
- 4.208. Another potential purchaser suggested that, given the proposed offtake arrangements, paragraph 4 of this condition, regarding the avoidance of discrimination in the provision of services, should include a reference to other licensees or DN owners.

### *Shippers/suppliers*

- 4.209. One shipper/supplier considered that this standard special condition should be amended to ensure that a consolidated record of priority customers listed under paragraph 17 is maintained by the National Emergency Coordinator, and that this process is supported by all GTs.

### *DISG comments*

- 4.210. The licence condition drafting for Standard Special Condition A8 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.

4.211. During these DISG meetings, one shipper/supplier stated that there should be a clear obligation for DNs to inform the appropriate shippers and suppliers in the event of an interruption of supply, even in the instances where another GT may be providing emergency services on their network. One potential purchaser also stated that it remained concerned about any instances where services were provided as a “free good” to NGT.

### **Ofgem’s proposals**

4.212. Following consideration of respondents’ views, and discussions with the HSE, Ofgem proposes to leave the provisions of Standard Special Condition A8 unchanged, with the exception of a modification to paragraph 12 to clarify the licensee’s obligations with respect to informing shippers and suppliers even where another GT may be directing the interruption.

4.213. Ofgem proposes that the provisions of Amended Standard Condition 6 be placed in Standard Special Condition A8 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 6 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.

4.214. Ofgem invites respondents’ views on its proposals for Standard Condition 6. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 7 – Provision of Information Relating to Gas Illegally Taken***

### **Description**

4.215. This condition allows for the investigation and recovery of the value of gas illegally taken, as well as the amendment of shipper charges and payment of

allowances to suppliers to account for the costs incurred during this process subject to the provisions of Schedule 2B of the Gas Act.

- 4.216. Under the provision of this condition, the licensee is also required to restore the safety of meters or installations at the request of the relevant shipper, where the meter or installation is unsafe as the result of an offence or an attempted offence relating to the theft of gas.

### **Next Steps document**

- 4.217. In the next steps document Ofgem stated that it considered that it would be appropriate for Standard Condition 7 to apply to all GT licence holders.

### **Respondents' views**

#### *NGT*

- 4.218. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.219. One potential purchaser agreed with the application and drafting of this licence condition.

#### *Shippers/suppliers*

- 4.220. One shipper/supplier suggested that either Standard Condition 7 should be amended to require the establishment of a common methodology across GTs for estimating volumes of gas abstracted. Alternatively, this shipper/supplier suggested that for the DNs and NTS, this condition should be replaced by or supplemented with a standard special condition applicable to both the NTS and DNs covering this issue.

#### *DISG comments*

- 4.221. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.



## **Ofgem's proposals**

- 4.222. Following full consideration of respondents' views, Ofgem continues to believe that it is not necessary to make any changes to Standard Condition 7 as part of the DN sales process and that the condition should apply to all GTs including NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.
- 4.223. In relation to the shipper/suppliers comment concerning a common methodology across GTs for estimating volumes of gas abstracted, the rules associated with theft of gas are set out within the UNC and are therefore common to both the NTS and DN-GTs. Ofgem therefore considers that no amendments need to be made to this licence condition to address this issue.
- 4.224. In terms of a common methodology for estimating volumes of gas theft from GT networks, an overall percentage is assumed for losses, which is then split (again, with an assumed proportion, given the infeasibility of estimating volumes more accurately) between the GTs and the suppliers. Further consideration of this methodology will be outside the scope of the DKNY sales process, and does not fetter Ofgem in any way as regards the application of this stated methodology.
- 4.225. Ofgem invites respondents' views on its proposals for Standard Condition 7. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 8 – Provision and Return of meters***

- 4.226. Amended Standard Condition 8 places a requirement on Transco to comply with any reasonable request received from a relevant supplier to provide, through a Meter Asset Manager, and install at the premises of a domestic customer, a gas meter owned by Transco which is of a type specified by the supplier.

## **Next Steps document**

- 4.227. As set out in Chapter 3, in the next steps document Ofgem stated that it continued to believe that it would be appropriate to introduce a standard special condition for NTS and DN licensees to replicate the provisions in Amended Standard Condition 8.
- 4.228. In response to the submission to the September document, which set out that the provisions should only apply to the NTS and RDN licensees, Ofgem detailed that it could not see any justification for the imposition of different metering obligations on RDNs as compared with IDNs. Ofgem stated that, throughout the DN sales process, it had been clear that the “metering of last resort” obligations would reside with the respective network operator for each area regardless of ownership. In this regard Ofgem set out that it remained of the view that IDNs could meet this obligation by contracting with Transco Metering Services, or an alternative metering services provider, for the provision of these services to customers on its network.

## **Respondents’ views**

### *NGT*

- 4.229. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.230. One potential purchaser accepted the application and drafting of Standard Special Condition A10 and the assumed reversion of Amended Standard Condition 8 to a standard condition that would then be switched off.
- 4.231. Two potential purchasers disagreed with Ofgem’s conclusions. One of these potential purchasers considered that the condition would impose significant issues in respect of stranded assets for the new DN owners, the extent of which would not apply to the RDNs. Therefore, this potential purchaser suggested that it would not be appropriate for this condition to be a standard special condition that would apply equally to NGT’s licensed businesses as well as the IDNs. This potential purchaser recognised that it may be difficult to draft a licence condition that would place a requirement on NGT and not IDNs in this respect. However,

the potential purchaser suggested that it would be possible to place the obligation on Transco to provide a metering obligation of last resort irrespective of whether they were the owner of the DN.

4.232. This potential purchaser also considered that the implications that the imposition of a metering provider of last resort obligation would have on Review of Gas Metering Arrangements (RGMA) systems and processes had not been sufficiently analysed. As such, the potential purchaser considered that the requirement should only apply to Transco's metering business, until such time as the metering provider of last resort obligation was removed.

4.233. The other potential purchaser that opposed Ofgem's proposals pointed out that the achievement of competition in metering would require a range of competitive providers to be established and to become operative within the market. With this in mind, the potential purchaser highlighted that the implementation of an obligation on IDNs to provide a metering service of last resort would require these parties to establish a metering business from scratch and would therefore involve significant start up costs which would likely be passed on to customers. This potential purchaser considered that the obligation should simply be retained on Transco as the incumbent metering provider.

#### *Shippers/suppliers*

4.234. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document

#### *DISG comments*

4.235. The licence condition drafting for Standard Special Condition A10 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.

4.236. One potential purchaser asked how the obligation on IDNs to keep meters in safe custody would work as Transco would not be providing meters.

- 4.237. This potential purchaser also stated that they continued to believe it to be inappropriate for the IDNs to have a metering obligation of last resort. They added that until the metering obligation of last resort is removed altogether, this licence obligation should apply only to NGT's metering business. They explained that this could be provided quite easily by the RDN licence having a special licence condition that applies to it only and that references to it should refer to suppliers, rather than relevant suppliers, so that the obligation applies to domestic meters attached to the total system rather than the system to which the licence relates. They added that this would also avoid any risk that NGT's metering business would avoid direct regulation by Ofgem a result of the sale.
- 4.238. One potential purchaser stated that it had difficulties in understanding the definition for "meter related service business", as the new definition excludes daily meter reading.

### **Ofgem's proposals**

- 4.239. As discussed in Chapter 3, and following consideration of respondents' views, Ofgem continues to propose that the provisions of Amended Standard Condition 8 be placed in Standard Special Condition A10 applicable to all NTS and DN-GTs. Ofgem considers that providing meters of last resort is a GT obligation and, as such, should be applicable to all NTS and DN-GTs. Ofgem believes that it should be the responsibility of the GT as to how they contractually discharge this obligation.
- 4.240. Modifications to these provisions include, but are not limited to, the following clarifications:
- ◆ that suppliers referred to are, in all cases, the *relevant* supplier, and as such, that the meter provider of last resort obligation is in relation to the pipe-line system of the licensee only; and
  - ◆ that the definition of meter-related services is within Transco's Network Code at 12 July 2004 (as distinct from any future versions of the uniform network code).

- 4.241. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 8 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.242. Ofgem invites respondents' views on its proposals for Amended Standard Condition 8. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 9 – Network Code***

### **Description**

- 4.243. This condition obliges the licensee to establish a network code to facilitate the achievement of one of a number of specified code objectives including, amongst other things, the efficient and economic operation of its pipeline system and the efficient discharge of its obligations under its GT licence.
- 4.244. Amended Standard Condition 9 also requires the licensee to establish code modification rules which set out the procedures for reviewing the network code and the conduct of proposals. The Authority's approval is required to modify the Network Code and the Authority retains the power to direct modifications to the Network Code without consultation. Changes to code modification rules may only take place with the consent of the Authority following consultation with relevant shippers.

### **Next Steps document**

- 4.245. As set out in Chapter 3, in the next steps document Ofgem stated that it would be appropriate for the offtake arrangements to be set out within the UNC and that there would not be a separate offtake code. In addition Ofgem considered that the Joint Office should have responsibility for the administration of the UNC modification procedures.

- 4.246. In response to views expressed by two respondents in relation to the provisions allowing consent to modify, Ofgem considered that it would be appropriate to retain these provisions within all NTS and DN-GT licences.
- 4.247. Similarly, with respect to the proposed implementation of a relevant objective regarding the efficient administration and implementation of arrangements, Ofgem considered that this objective would be necessary, despite views expressed by NGT. Ofgem considered that it would be important to be able to measure modification proposals against this objective particularly as regards the provisions of the Network Code which relate to the Joint Office and Agency.
- 4.248. In relation to a comment raised by one respondent that there would need to be an obligation on both the NTS and DN-GTs to be party to the Agency arrangements, Ofgem considered that this obligation should be imposed through a new licence condition regarding agency arrangements (Standard Special Condition A15).
- 4.249. Ofgem also stated, in the next steps document, that it considered the relevant objectives of the network code, as set out in Standard Special Condition A11, to be sufficient criteria for Ofgem to use when deciding whether to direct a modification especially in view of the fact that they involve an assessment of the advantages and disadvantages of any modification proposals.
- 4.250. Ofgem agreed with the views of respondents and DISG participants who stated that the modification rules of the UNC should sit within the UNC itself.
- 4.251. Ofgem noted the view of one respondent that cost benefit analysis should be undertaken for major modification proposals. However, Ofgem considered that it should also be recognised that the Authority has obligations under section 5A of the Utilities Act to carry out impact assessments with respect to network code proposals that the Authority considers to be important within the meaning of section 5A(2) of the Utilities Act.
- 4.252. With respect to a point raised at DISG meetings regarding the potential expansion of this condition to cover transitional arrangements, Ofgem did not consider that this would be necessary as these issues were being progressed through Transco's UNC development forum.

4.253. Ofgem detailed that it had drafted a standard special condition for NTS and DN-GTs to replace Amended Standard Condition 9. In this regard, Ofgem set out that Standard Special Condition A11 was substantially different from the current Amended Standard Condition 9, to reflect the new governance and industry code arrangements that were discussed substantially through workgroup processes and in the September document. The key changes were:

- ◆ the introduction of a new relevant objective: to ensure the co-ordinated, efficient and economical development of pipeline systems, so far as it would be consistent with the efficient and economic development of the licensee's pipeline system. Ofgem set out that it did not consider that it would be appropriate to introduce this relevant objective into the licences of IGTs as this was not central to the DN sales process;
- ◆ the introduction of a second new relevant objective relating to the promotion of efficiency in the implementation and administration of the Network Code. This provision was designed to govern both the Agency and the Joint Office arrangements. These provisions were set out in paragraph 1 of Standard Special Condition A11; and
- ◆ requirements on licensees to create and be party to a UNC with SFCs for each gas transporter that was to become a signatory to the UNC.

4.254. In addition to the requirements set out in Standard Special Condition A11, Ofgem considered that three new conditions were required to augment these provisions. These related to the requirements for Independence of the Balancing Arrangements (Standard Special Condition A16 and NTS Special Condition C6) and LNG related provisions (NTS Special Condition C1).

4.255. To address the issue of LNG Storage, Ofgem further proposed that:

- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS special condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph (6)).

4.256. Ofgem stated that it was also intending to introduce new requirements associated with both the Joint Office, the Common Systems Arrangements (CSA) and the Agency arrangements (Standard Special Condition A12, A14 and A15 respectively).

### **Respondents' views**

4.257. Ofgem received a number of views from respondents concerning the Network Code condition. These views are summarised in Chapter 3. Overall, there was general support for Ofgem's proposals:

- ◆ Two respondents supported the offtake arrangement being in a separate code (with the expectation of relevant technical aspects being contained in separate documents which could not be amended by the UNC modification process)
- ◆ One respondent considered that the Joint Office should be more 'constitutionally' separate from Transco;
- ◆ One respondent stated that all commercial offtake rules should reside within the UNC;
- ◆ One respondent welcomed the addition relevant objective on the licensees to promote efficiency in the implementation and administration of the Network Code; and
- ◆ Two respondents preferred the UNC only approach with the modification being managed by the Joint Office.

4.258. In this section, we summarise comments made in relation to the drafting of Standard Special Condition A11 specifically.

### *NGT*

4.259. As discussed in Chapter 3, NGT raised a number of issues in relation to the network code. NGT agreed that the commercial rules that relate to the offtake of gas at all NTS exit points should reside in the UNC, and that the more technical operator-to-operator arrangements should reside in separate agreements between



NTS and the DNs with an additional section in the UNC defining the scope of the NTS/DN operator arrangements.

- 4.260. In addition NGT suggested in respect to this licence condition that the phrase within paragraph 9(c) “where the Authority otherwise consents” is replaced with “where the Authority agrees otherwise”.

#### *Potential Purchasers*

- 4.261. In addition to the high-level comments summarised in Chapter 3, potential purchasers had a number of specific comments regarding Standard Special Condition A11. One potential purchaser accepted the UNC / SFC structure. This potential purchaser also supported placing the code modification rules within the UNC and suggested that the licence drafting was over-prescriptive.
- 4.262. Another potential purchaser agreed with Ofgem’s view that unaffected parties should not be able to raise any modifications to the separate agreements containing the technical offtake arrangements that are ancillary to the UNC documents.
- 4.263. One potential purchaser also suggested that the ability to propose modifications to any DN level SFC should be restricted, so far as shippers and suppliers are concerned, to parties that have signed the relevant framework agreement to that code. Whilst another potential purchaser did not agree that the SFCs should be capable of being modified by the licensee's own shippers and by the shippers of other DNs and the NTS. This potential purchaser also questioned the wording of paragraph 9(c) of the draft within the next steps document.
- 4.264. The same potential purchaser suggested that it was not clear from the text which definition of network code is being used. This purchaser suggested that the convention should be that references to network code mean the licensee's own code and where it is intended to refer to the common arrangements that the term UNC should be used.

#### *Shippers/suppliers*

- 4.265. High-level comments raised by shippers/suppliers in relation to network code issues are summarised in Chapter 3. However, in relation to modification of the UNC, shippers/suppliers commented that any changes to gas transportation

arrangements should be subject only to the change procedures set out in the UNC modification rules.

- 4.266. In addition shippers/suppliers had a number of comments on Standard Special Condition A11. One shipper/supplier supported Ofgem's view that it is necessary for transporters to introduce a new relevant objective to promote efficiency in the implementation and administration of the Network Code and Joint Office and Agency and also to require them to be party to the UNC and agency arrangements.
- 4.267. This shipper/supplier suggested that this licence condition could be more explicit by requiring the listing of activities and detailed processes managed under the common services agreement within the UNC. The respondent suggested that this would be another essential safeguard for users if changes to these arrangements were proposed. The shipper/supplier considered that this is particularly important given that the transporters' own xoserve and corporate governance arrangements currently being established ensure that this organisation is run for the benefit of the transporters.
- 4.268. Another shipper/supplier suggested that whilst the drafting obliges the transporters to jointly operate a Joint Office, the drafting does not oblige the transporters to process all network code or UNC modifications through the Joint Office. This shipper/supplier also suggested that the current drafting does not appear to contain an explicit obligation on the transporters to propose consequential modifications to the SFC should changes to the UNC render this necessary.
- 4.269. Another shipper/supplier considered that the primary relevant objective of all transporters should be the co-ordinated, efficient and economical operation of the combined pipe-line system as a whole and that the condition should be re-drafted to reflect this. This shipper/supplier also suggested that the reference in paragraph 4 to "except where the Authority agrees otherwise" should be deleted as if a particular condition within the UNC was not felt by the Authority to be appropriate for one DN then it should not be appropriate for all DNs to prevent fragmentation. This shipper/supplier also suggested that the reference to "unless the Authority agrees otherwise" should be deleted from paragraph 8 as the respondent considered that the Network Code modification procedure should

always be included within UNC to give adequate protection to shippers. In addition, this shipper/supplier also suggested that the reference to "except in a case where the Authority otherwise consents" should also be removed from paragraph 9(c) as the respondent held the view that changes to individual network codes should always result in an accompanying change to the UNC otherwise fragmentation could result.

*DISG comments*

- 4.270. The licence condition drafting for Standard Special Condition A11 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32, DISG33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached for information in Appendix 2.
- 4.271. One potential purchaser stated that they agreed with those who suggested removing the requirement for a mechanism for review. They further stated that, while they believed that it would be appropriate to have a mechanism for modification, over-formalising review requirements could lead to unnecessary procedure changes and hence additional costs.
- 4.272. One potential purchaser stated that it did not understand why paragraphs 1(a)(2) and 10(b)(2) had been amended to prevent a person who raised a modification to the UNC or network code from raising an alternative modification. They stated that this drafting was too restrictive and to the extent that this limitation is deemed appropriate, should be provided for within the associated modification rules.
- 4.273. Another potential purchaser stated that since there is a very limited area in paragraph 1(d)(iii) where Ofgem envisages potential competition between shippers and DNs in relation to exit capacity trading, it did not believe that it would be appropriate to have this drafted as a broad obligation that applies to the generality of the transportation arrangements.
- 4.274. One shipper/supplier stated that the paragraph 10(b) and 11(b) drafting raised some concerns that the definition of "alternative" might affect legitimate

refinements of proposals during the workgroup phase and possibly prevent “alternative” proposals being considered under a separate modification number.

4.275. Another shipper/supplier stated that since the primary relevant objective of all transporters should be the co-ordinated, efficient and economical operation of the combined pipe-line system as a whole, therefore this condition should be re-drafted such that paragraph 1(a) becomes 1(b) and 1(b) becomes 1(a). The respondent also expressed the view that the reference in paragraph 4 to “except where the Authority agrees otherwise” be deleted as the whole purpose of having a UNC is to ensure that arrangements within it apply equally to all DNs. The shipper/supplier stated if the Authority considered that a particular condition within the UNC was not appropriate for one DN then it should not be appropriate for all DNs. The respondent elaborated further that drafting as currently written could increase the scope for fragmentation of common systems and processes and that no such similar exception applies to the Joint Office governance condition (which is also designed to prevent fragmentation occurring).

### **Ofgem’s proposals**

4.276. The network code licence conditions are important for ensuring effective governance. Ofgem’s high level proposals of including the following conditions remain unchanged:

- ◆ Network Code;
- ◆ Joint Office (this condition is discussed in Chapter 5 with respect to Standard Special Condition A12);
- ◆ Agency<sup>33</sup> (this condition is discussed in Chapter 5 with respect to Standard Special Condition A15) -
- ◆ Independent market for balancing (this condition is discussed in Chapter 5 with respect to Standard Special Condition A16); and

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<sup>33</sup> Please note that the common systems obligation and agency obligation have been merged. Please see chapter 5 for further information.

- ◆ Augmenting provisions for NTS use of LNG Storage (this condition is discussed in Chapter 5 with respect to Special Condition C1).

4.277. Following consideration of respondents' views, Ofgem has made a number of modifications to clarify the drafting of Standard Special Condition A11, including, but not limited to:

- ◆ modification of paragraph 1(d) to reflect a requirement for the securing of effective competition between DN operators and relevant shippers, consistent with the terms of the DTI's proposed exemption;
- ◆ modification of paragraph 1(f) to reflect a requirement within the relevant objectives for the promotion of efficiency in the implementation and administration of the Network Code and/or the UNC;
- ◆ the insertion of paragraph 4, to reflect the fact that Transco may, with the consent of the licensee, prepare a single network code with respect to both its NTS and RDN licences;
- ◆ the removal of the provisions relating to the network code modification procedures providing for a mechanism for the review of the UNC and network codes;
- ◆ the insertion of paragraphs 10 and 11 to clarify the parties who are able to make modification proposals in relation to the UNC and the network code respectively;
- ◆ the clarification, in the case of paragraph 11 (a)(i), that the NTS should not be able to modify the provisions of Transco's network code unless they relate to the business of the NTS;
- ◆ the insertion of sub-paragraph 17(c) requiring the licensee to provide, or cause to be provided, publication of the network code and UNC on a web-site which is freely available to interested parties;
- ◆ the removal of paragraph 17 in the draft of Standard Special Condition A11 published in the next steps document, and insertion into Standard Special Condition A12;

- ◆ the removal of the designated storage provisions in paragraphs 18 and 19 in the draft of Standard Special Condition A11 published in the next steps document, such that paragraphs 20 and 21 in the current draft of Standard Special Condition A11 are “not used” but rather augmented by paragraph 6 of Special Condition C1;
- ◆ the removal of the definition of “relevant gas transporter” which is now defined generically in Standard Special Condition A3; and
- ◆ the removal of the “Individual Network Code” definition and use of the phrase “network code (excluding the terms of the UNC incorporated within it” instead.

4.278. Ofgem proposes that the provisions of Amended Standard Condition 9 be placed, subject to the above modifications, in Standard Special Condition A11 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 9 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.

4.279. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 9. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **Related consultation**

4.280. It is important to note that the UNC and in particular modification rules are presently not finalised. Therefore, Ofgem notes that there may be a need for further changes to this licence condition depending on the outcome of the finalised UNC and modification rules. If further changes are required, Ofgem will undertake such changes at the May section 23 consultation.

## ***Standard Condition 13 – Change co-ordination for the Utilities Act 2000***

### **Description**

- 4.281. This condition requires the licensee to take all reasonable measures to secure, and implement, specified industry framework documents necessary to give full effect to the Utilities Act 2000. The condition is now time expired.

### **Next Steps document**

- 4.282. In the next steps document Ofgem acknowledged that its proposals for Standard Condition 13 did not directly relate to DN sales. However, Ofgem believed that it would be desirable, as part of this process, to switch off time expired conditions to give clarity to licensees (particularly any new purchasers of DNs) as to the obligations within their licence. Ofgem therefore proposed to switch off this condition and to switch this condition off in the licences of other GTs at a suitable opportunity.

### **Respondents' views**

#### *NGT*

- 4.283. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.284. One potential purchaser agreed that this condition should be switched off.

#### *Shippers/suppliers*

- 4.285. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.286. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity

to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.287. Ofgem continues to believe that it would be desirable, as part of this process, to switch off time expired conditions to give clarity to licensees (particularly any new purchasers of DNs) as to the obligations within their licence. Ofgem therefore proposes to switch off this condition and to switch this condition off in the licences of other GTs at a suitable opportunity. The drafting for this condition is provided for comment in Appendix 7.
- 4.288. Ofgem invites respondents' views on its proposals for Standard Condition 13. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 14 – The Supply Point Administration Agreement***

### **Description**

- 4.289. Standard Condition 14 was recently introduced and requires the licensee to be a party to and comply with the relevant provisions of the Supply Point Administration Agreement (SPAA).

### **Next Steps document**

- 4.290. In the next steps document Ofgem proposed that Standard Condition 14 should continue to apply to all GT licences including NTS and DN-GTs.

### **Respondents' views**

*NGT*



4.291. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

*Potential Purchasers*

4.292. One potential purchaser accepted the application and drafting of Standard Condition 14.

*Shippers/suppliers*

4.293. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

*DISG comments*

4.294. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

**Ofgem's proposals**

4.295. Ofgem continues to believe that no changes to Standard Condition 14 are necessary to protect the interests of customers as part of the DN sales process and that the condition should apply to all GTs including NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.

4.296. Ofgem invites respondents' views on its proposals for Standard Condition 14. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 16 – Pipe-line System Security Standards***

### **Description**

- 4.297. Under Standard Condition 16 the licensee is required to plan and develop its pipeline system to enable it to meet the peak daily demand for gas such that the ability of the pipeline system to meet that demand is only expected to be exceeded in 1 year out of 20 based on the previous 50 years of data (the 1 in 20 obligation).

### **Next Steps document**

- 4.298. As set out in Chapter 3, in the next steps document Ofgem stated that it may be necessary to modify Standard Condition 16 to reflect Transco's proposals for the NTS exit flexibility product. Ofgem clarified that if any such modifications were required, it would seek to ensure that the revised condition had the same effect as it currently has under Transco's common ownership. Ofgem detailed that these issues were still in consideration through Transco's exit development forum and that Ofgem would not therefore be proposing any modifications or providing any drafting in relation to Standard Condition 16 as part of the next steps document.
- 4.299. Ofgem proposed that Standard Condition 16 should apply to all GTs including NTS and DN licensees but detailed that if Ofgem were to consider, later in the process, that further modifications were required then these would be informally consulted upon through the DISG.
- 4.300. However, Ofgem identified that this condition may require modification of a technical nature to reflect Transco's proposals in relation to the NTS exit flexibility product. Ofgem detailed that, at present, customers directly connected to the NTS are required to purchase a level of maximum daily offtake quantity (MDQ) consistent with their maximum hourly offtake quantity (MHQ), and each customer is not permitted to exceed 1/24<sup>th</sup> of its MDQ in any given hour. Ofgem explained that, under the offtake arrangements, it had been proposed that NTS exit flexibility would be defined as a separate product and that it would be allocated and traded in the same way as firm NTS exit capacity.

In this respect, Ofgem stated that this would enable some customers to meet their required level of MHQ through the purchase of NTS exit flexibility, and therefore reduce their purchased level of MDQ.

4.301. In relation to the concern expressed regarding short term allocations of capacity and interactions with the 1 in 20 obligation, Ofgem noted that the arrangements had been specifically designed to ensure that DNs could procure capacity on a long term basis and, therefore, meet its 1 in 20 obligation, irrespective of the arrangements for the allocation of capacity in the short term.

### **Respondents' views**

#### *NGT*

4.302. As discussed in Chapter 3, NGT considered that it was appropriate to keep the 1 in 20 obligation but that it would be inappropriate to review the 1 in 20 obligation to acknowledge the flow flexibility product 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; and
- ◆ any strengthening of the security standards would need time to develop and have implications for the funding of associated investments. Such a change would best be handled via the price control review process.

4.303. In addition NGT commented on this licence condition that the requirement that the 1 in 20 obligation should be calculated on the previous 50 years of data should be made more flexible in the number of years of data to be used so as to adapt to statistical trends such as climate change.

#### *Potential Purchasers*

4.304. As discussed previously in Chapter 3 potential purchasers raised the following issues:

- ◆ the security standard should be applied uniformly, and that technical details need to be consistent;

- ◆ the pipeline system security standards licence obligation should not be changed to reflect the introduction of the proposed flexibility product; and
- ◆ there is a fundamental difference in the way that a DN secures its capacity (and flexibility) requirements compared to Transco as an integrated business.

4.305. In addition one potential purchaser commented on this licence condition that they accepted the need for explicit statements on planning standards and is comfortable with the proposal to continue the 1 in 20 obligation.

#### *Shippers/suppliers*

4.306. A number of shippers/suppliers commented on this licence condition. The high level views of respondents are set out in Chapter 3.

4.307. Three shippers/suppliers agreed with Ofgem that the 1 in 20 obligation should apply to DNs as well as the NTS as this will ensure that there is a commitment from these parties to develop their networks to meet daily demands. One of these respondents was concerned that Ofgem was proposing to amend one of the standard conditions to accommodate the offtake arrangements and the flexibility product, which this respondent did not support.

4.308. One shipper/supplier suggested that Ofgem should not reinterpret the definition of the 1 in 20 obligation in respect of the NTS, to help facilitate the introduction of the new radical changes to the exit regime. This shipper/supplier suggested that the current licence conditions provide comfort to firm NTS direct connects that Transco will continue to make available daily capacity incorporating within-day flexibility at flows up to 1/24 of the maximum daily quantity. This shipper/supplier suggested that it is important that any new licence conditions do not diminish the rights enjoyed by firm NTS direct connects through the introduction of an obligation which combines both booked Maximum Daily Quantity (MDQ) (primary capacity) with Maximum Hourly Quantity (MHQ) (within-day flexibility).

4.309. Another shipper/supplier considered that either consistency of the methodologies used for calculation of the 1 in 20 and 1 in 50 peaks should be

required, or, at least transparency of the methodologies used should be provided. This shipper/supplier suggested that this could be achieved by the addition of a further standard special condition, or by switching this condition off for the NTS and DNs and replacement by a standard special condition.

*DISG comments*

- 4.310. At DISG 34 Ofgem proposed to switch off Standard Condition 16 and insert the provisions of this condition into a new standard special condition, with paragraph 2 modified appropriately to reflect the NTS exit flow flexibility product. At this meeting, Ofgem suggested the insertion of the words “including, but not limited to, aggregate peak hourly demand”. The minutes of this meeting are attached in Appendix 2.
- 4.311. NGT considered that the inclusion of an aggregate peak hour demand standard placed upon gas transporters an uncertain obligation with no corresponding beneficial effect. NGT had suggested its own drafting that would meet Ofgem’s objectives and without triggering a review of obligations, and appealed for it to replace the aggregate peak hour demand standard.
- 4.312. NGT also considered that Ofgem should question whether it is appropriate to require gas transporters to publish further information such as Planning Policy procedures; in particular as this area of activity is effectively regulated by the Health and Safety Executive (HSE).
- 4.313. Several potential purchasers stated that they did not support the amendment in paragraph 2 where the words “including, but not limited to, aggregate peak hourly demand,” had been added. One potential purchaser believed that this had fundamentally changed the existing security of supply obligation by forcing it from being a daily regime to an hourly regime. Another potential purchaser stated that while they accepted the provisions in this condition in general, they did not believe that the new insertion to require the planning standard to include aggregate peak hourly demand was workable. In principle, this respondent stated that it would require it either to build a network to meet peak hourly demands which, given that this had not been done in the past, was likely to be inefficient, or buy a product to allow it to manage hourly flexibility. However, the respondent stated that the product currently proposed by NGT was not an hourly product, but a 16 hour product which allowed this buyer to profile their

offtake over the period. If an hourly peak demand condition applied, the potential purchaser expressed the concern that this may move them towards either hourly balancing, or an hourly flex product, neither of which have been the subject of recent consultation.

4.314. Another potential purchaser stated that this reference to aggregate peak hourly demand might have significant impact on network design. They therefore wished to understand why this requirement has been introduced and what Ofgem envisages is the impact of this change. In any event they did not believe this change is connected to the sale process and hence were of the view that it should be removed from the licence.

4.315. Following further consideration of respondents' views, the licence drafting for Standard Special Condition A9 (Pipe-Line System Security Standards) was further revised such that the words inserted within paragraph 2 were changed to "including, but not limited to, within day gas flow variations on that day". This drafting was presented for discussion at DISG 35.

4.316. This wording was agreed to be acceptable by NGT, however, NGT maintained that such words were not necessary.

### **Ofgem's proposals**

4.317. Following consideration of respondents' views, Ofgem proposes that the following wording is inserted into Standard Special Condition A9: "including, but not limited to, within day gas flow variations on that day".

4.318. It is important to note that these amendments are needed to ensure that the 1 in 20 standard is not diminished and is as effective in a divested industry structure. In addition the changes made ensure that there is clarity for the all the new distribution owners. Ofgem's proposals are to ensure that the present status quo is maintained. As stated in Chapter 3, the HSE has stated that it is content with the proposed wording of this licence condition.

4.319. Ofgem agrees that transparency in the methodologies applied by different GTs with respect to their 1 in 20 obligations may be beneficial. However, Ofgem is of the view that such obligations may more appropriately sit within the UNC. As such, transparency provisions are not being progressed as a licence obligation

within this consultation. It is important to note that the UNC and in particular modification rules are presently not finalised and will be subject to additional consultation by Ofgem. Therefore, Ofgem notes that there may be a need for further changes to this licence condition depending on the outcome of the finalised UNC and modification rules. If further changes are required, Ofgem will undertake such changes at the May section 23 consultation.

- 4.320. Ofgem therefore proposes that the provisions of Standard Condition 16, subject to the above modifications, be placed in Standard Special Condition A9 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 16 will then be switched off.
- 4.321. Ofgem invites respondents' views on its proposals for Standard Condition 16. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Amended Standard Condition 17 – Provision of Services for Persons who are of Pensionable Age or Disabled or Chronically Sick: Arrangements in respect of Meters***

#### **Description**

- 4.322. Amended Standard Condition 17 requires that Transco must comply with any request received from a gas supplier in relation to the repositioning of meters that it owns for customers who are of pensionable age, disabled or chronically sick. This is provided that the relevant supplier pays Transco's reasonable expenses in doing so. This condition was amended in Transco plc's GT licence as part of the RGMA changes introduced in July 2004.

## **Next Steps document**

- 4.323. In the next steps document Ofgem stated that following consideration of respondents' views, expressed in relation to the September document, Ofgem considered that it would be appropriate for this licence condition to apply to all NTS and DN-GT licensees. Ofgem set out that it did not see any justification for introducing different provisions for RDN and IDN-GT licensees and therefore that it did not consider that the metering of last resort obligations should apply only to Transco's RDNs.
- 4.324. In response to comments from NGT, that this obligation should be amended such that it would only apply to GTs that have one or more domestic customer connected to their network, Ofgem stated that it did not consider that this would be necessary as the condition is already drafted in such a way as to only require action in respect of domestic customers. Ofgem therefore proposed that the current provisions of Amended Standard Condition 17 should be introduced as a standard special condition in the licences of all NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.325. NGT suggested that the condition should be amended to allow for the possibility that the GT may not own the meter that requires repositioning (paragraph 1(a)). As such, NGT suggested that the drafting of this condition should be modified to state that where a supplier has "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".

### *Potential Purchasers*

- 4.326. One potential purchaser accepted the application and drafting of Standard Special Condition A19, and the associated reversion of Amended Standard Condition 17 to a standard condition that would then be switched off.

### *Shippers/suppliers*

- 4.327. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document



### *DISG comments*

- 4.328. The licence condition drafting for Standard Special Condition A19 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 4.329. One potential purchaser did not believe that it would be appropriate for the IDNs to have a metering obligation of last resort. As such, this potential purchaser was of the opinion that this condition should become a special condition applicable only to the RDNs. Accordingly, the respondent considered that a requirement should be placed upon the RDNs to provide a repositioning service, to relevant customers where requested, across the total pipeline system. This respondent set out that an additional requirement could also be placed upon suppliers to supplement this obligation.

### **Ofgem's proposals**

- 4.330. As discussed in Chapter 3, Ofgem continues to consider that it would be appropriate for licence conditions relating to meter services of last resort to apply to all NTS and DN-GT licensees. Ofgem does not see any justification for introducing different provisions for RDN and IDN-GT licensees and therefore it does not consider that the metering of last resort obligations should apply only to Transco's RDNs.
- 4.331. Ofgem also continues to believe that this condition is drafted in such a way as to only require action in respect of domestic customers. Ofgem therefore proposes that the current provisions of Amended Standard Condition 17 should be introduced as a standard special condition in the licences of all NTS and DN-GTs. This is consistent with Ofgem's proposed approach to all of the metering conditions in the licence, in that they will remain applicable to the NTS as well as the DN-GTs.
- 4.332. In addition, Ofgem proposes that the provisions of Amended Standard Condition 17 should be placed in Standard Special Condition A19 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in

Appendix 8A. In line with this, Amended Standard Condition 17 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.

- 4.333. Ofgem invites respondents' views on its proposals for Amended Standard Condition 17. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 18 – Provision of Services for Persons who are Blind or Deaf***

### **Description**

- 4.334. This condition requires licensees to prepare and submit to the Authority for approval a code of practice detailing the special services that will be made available for domestic customers who are disabled by virtue of being blind or partially sighted, or deaf or hearing impaired.

### **Next Steps document**

- 4.335. In the next steps document Ofgem stated that it would be appropriate for this condition to be drafted such that it would only apply to GT licensees when they have one or more domestic customers connected to their networks. Ofgem considered that this would avoid an obligation to produce a code which would be redundant by virtue of there being no domestic customers connected to the network.
- 4.336. Ofgem also proposed to amend this condition such that the Authority may approve a date later than 1 November 2001 in order to avoid an automatic breach of this obligation by new licensees.
- 4.337. As such, Ofgem proposed that the provisions set out in the corresponding standard condition would be amended in line with these proposals and placed in a standard special condition applicable to all NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.338. NGT proposed that only DNs should have these obligations and the “one or more domestic customer” caveats in Standard Special Condition A20 and Standard Special Condition A23 should remain.

### *Potential Purchasers*

- 4.339. One potential purchaser accepted the application and drafting of Standard Special Condition A20 and the associated switching off of Standard Condition 18.

### *Shippers/suppliers*

- 4.340. One shipper/supplier suggested that the first paragraph should be amended so that it is not limited to those instances where domestic customers are connected to the network.

### *DISG comments*

- 4.341. The licence condition drafting for Standard Special Condition A20 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 4.342. At DISG 29, one shipper/supplier queried whether the exclusion of the NTS from this obligation was appropriate given the provision of the 0800 emergency number by Transco to domestic customers.
- 4.343. Following consideration of respondents' views, Ofgem decided that the “one or more domestic customers” caveat should be removed. This is to ensure that this obligation is applicable to the NTS in addition to the DN-GTs. Ofgem believes that is necessary for this obligation to apply to the NTS given the operation of the 0800 number by the NTS on behalf of Transco. In response to this, one potential purchaser stated that they were unsure why this condition had been

made a standard special condition since the drafting now replicates that provided by the equivalent standard conditions save to the extent of the references to other conditions, all of which could be retained as standard conditions.

### **Ofgem's proposals**

- 4.344. As discussed above, Ofgem has removed the caveat that the obligation only applies if one or more domestic customers are connected, which is not believed to be appropriate, given the operation of the 0800 number by the NTS GT on behalf of Transco.
- 4.345. However, Ofgem notes that, relative to the wording of Standard Condition 18, one necessary modification still remains relating to the avoidance of an automatic breach of the licence. As such, it has been necessary to insert the words "or on such later date as the Authority may approve". Given this, it is not possible to revert Standard Special Condition A20 or any of the related licence conditions to standard conditions as suggested by one respondent.
- 4.346. Ofgem therefore proposes that the provisions of Standard Condition 18, subject to the modifications above, be placed in Standard Special Condition A20 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 18 will then be switched off.
- 4.347. Ofgem invites respondents' views on its proposals for Standard Condition 18. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 19 – Arrangements in Respect of Powers of Entry***

## **Description**

- 4.348. Standard Condition 19 requires the licence holder to prepare and submit a statement to the Authority regarding its proposed arrangements in respect of the steps to be taken under Standard Condition 19A (Authorisation of Officers).

## **Next Steps document**

- 4.349. In the next steps document Ofgem stated that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to apply only to GTs that have one or more domestic customer connected to their network.
- 4.350. Ofgem considered that it would be appropriate for this condition to apply to all NTS and DN-GTs. In view of the need to amend cross-references within the condition Ofgem set out that it would be necessary for the provisions contained in Standard Condition 19 to become a standard special condition applicable to NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.351. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.352. One potential purchaser accepted the application and drafting of Standard Special Condition A22 and the associated switching off of Standard Condition 19.

### *Shipper/suppliers*

- 4.353. No shipper/supplier provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

4.354. The licence condition drafting for Standard Special Condition A22 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

### **Ofgem's proposals**

4.355. Ofgem continues to believe that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to only apply to GTs that have one or more domestic customers connected to their network.

4.356. Ofgem therefore proposes that the provisions of Standard Condition 19 be placed in Standard Special Condition A22 applicable to all NTS and DN-GTs to ensure that the necessary cross-references can be amended. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 19 will then be switched off.

4.357. Ofgem invites respondents' views on its proposals for Standard Condition 19. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 19A – Authorisation of Officers***

### **Description**

4.358. This condition describes the requirements for officers to be appropriately qualified, identifiable by the public and to ensure that their equipment/identification is not misused. It also obliges licensees to inform relevant shippers, naming the agent in question.

## **Next Steps document**

- 4.359. In the next steps document Ofgem stated that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to apply only to GTs that have one or more domestic customers connected to their network.
- 4.360. Ofgem therefore considered that it would be appropriate for the current Standard Condition (Standard Condition 19A) to remain unchanged, and continue to apply to all GT licensees including all NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.361. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.362. One potential purchaser accepted the application and drafting of Standard Condition 19A.

### *Shippers/suppliers*

- 4.363. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.364. At DISG 34, Ofgem proposed that the provisions of Standard Condition 19A should be moved into a new standard special condition – Standard Special Condition A22A. Industry participants have therefore had the opportunity to provide detailed comments on this drafting, both during this meeting and by written responses after this meeting. The minutes of this meeting are attached in Appendix 2.

## **Ofgem's proposals**

- 4.365. Given the inclusion within Standard Condition 19A of cross-references to conditions that are proposed to be standard special conditions, Ofgem proposes that the provisions of Standard Condition 19A be placed in Standard Special Condition A22A applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 19A will then be switched off.
- 4.366. Ofgem invites respondents' views on its proposals for Standard Condition 19A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 19B – Exercise of Powers of Entry***

### **Description**

- 4.367. Standard Condition 19B requires the licensee to use reasonable endeavours to avoid undue disturbance to owners or occupiers of premises as a result of the exercise of the powers of entry conferred by Schedule 2B of the Gas Act.

### **Next Steps document**

- 4.368. In the next steps document Ofgem stated that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to apply only to GTs that have one or more domestic customer connected to their network.
- 4.369. Ofgem therefore considered that it would be appropriate for the current standard condition (Standard Condition 19B) to remain unchanged, and continue to apply to all GT licensees including all NTS and DN-GTs.



## **Respondents' views**

### *NGT*

- 4.370. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.371. One potential purchaser accepted the application and drafting of SC19B.

### *Shippers/suppliers*

- 4.372. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.373. At DISG 34, Ofgem proposed that the provisions of Standard Condition 19B should be moved into a new standard special condition – Standard Special Condition A22B. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of this meeting are attached in Appendix 2.

## **Ofgem's proposals**

- 4.374. As in Standard Condition 19A, given the inclusion within Standard Condition 19B of cross-references to conditions that are proposed to be standard special conditions, Ofgem proposes that the provisions of Standard Condition 19B be placed in Standard Special Condition A22B applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 19B will then be switched off.
- 4.375. Ofgem invites respondents' views on its proposals for Standard Condition 19B. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the

conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 20 – Standards of Performance***

### **Description**

- 4.376. This condition describes the conditions of payment of compensation to consumers under Section 33AA of the Gas Act.

### **Next Steps document**

- 4.377. In the next steps document Ofgem stated that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to only apply to GTs that have one or more domestic customers connected to their network.
- 4.378. Ofgem therefore considered that it would be appropriate for the current standard condition (Standard Condition 20) to remain unchanged, and continue to apply to all GT licensees including all NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.379. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchasers*

- 4.380. One potential purchaser accepted the application and drafting of Standard Condition 20.

#### *Shipper/suppliers*

- 4.381. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

4.382. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

4.383. Ofgem continues to believe that it would be appropriate for Standard Condition 20 to remain unchanged, and continue to apply to all GT licensees including all NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.

4.384. Ofgem invites respondents' views on its proposals for Standard Condition 20. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 21– Complaint Handling Procedure***

### **Description**

4.385. This condition requires the licensee to put in place a code of practice by 1 November 2001 detailing the procedure for handling complaints from domestic customers about the manner in which the licensee conducts its transportation business.

### **Next Steps document**

4.386. In the next steps document Ofgem stated that, following consideration of respondents' views, it considered that this condition should be drafted such that it would only apply to NTS and DN-GT licensees when they have one or more domestic customers connected to their networks. Ofgem was of the opinion that this would avoid an obligation to produce a code of practice which is redundant by virtue of there being no domestic customers connected to the network.

- 4.387. Ofgem also proposed to amend this condition such that the Authority may approve a date later than 1 November 2001 in order to avoid an automatic breach of this obligation by new licensees.
- 4.388. Furthermore, given the proposed amendments to Standard Condition 22, Ofgem considered that it would be necessary to amend some cross-references to this condition.
- 4.389. As such, Ofgem proposed that the provisions set out in the corresponding standard condition would be amended in line with these proposals and placed in a standard special condition applicable to all NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.390. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.391. Of the formal responses, one potential purchaser accepted the application and drafting of Standard Special Condition A23, and the associated switching off of Standard Condition 21.

#### *Shippers/suppliers*

- 4.392. One shipper/supplier noted that NTS could receive domestic complaints, especially in the event of a major incident.

#### *DISG comments*

- 4.393. The licence condition drafting for Standard Special Condition A23 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

4.394. Following consideration of respondents' views, Ofgem decided that the "one or more domestic customers" caveat should be removed. In response to this, one potential purchaser stated that they were unsure why this condition had been made a standard special condition since the drafting now replicates that provided by the equivalent standard conditions save to the extent of the references to other conditions, all of which could be retained as standard conditions.

### **Ofgem's proposals**

4.395. Ofgem agrees with the shipper/supplier that commented on this issue, and has therefore decided that the "one or more domestic customers" caveat is not appropriate as domestic customers may complain to the NTS, particularly after a major incident. In this case the NTS therefore needs procedures in place regarding how such complaints would be managed.

4.396. Ofgem also proposed to amend this condition such that the Authority may approve a date later than 1 November 2001 in order to avoid an automatic breach of this obligation by new licensees

4.397. Ofgem therefore proposes that the provisions of Standard Condition 21, subject to the modifications above, be placed in Standard Special Condition A23 applicable to all NTS and DN-GTs. Ofgem has had to amend this licence to ensure that, once this licence condition is switched on, the NTS and DN-GTs would not be an automatic breach of this licence condition. Ofgem has added an obligation which enables the Authority to direct the licensee to prove a statement in accordance with this licence obligation. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 21 will then be switched off.

4.398. Ofgem invites respondents' views on its proposals for Standard Condition 21. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 22 – Preparation, Review of and Compliance with Statements and Codes***

### **Description**

- 4.399. Standard Condition 22 details licensee obligations with respect to the statements and codes required pursuant to Standard Conditions 18, 19 and 21, such as the need to consult the Consumer Council and the obligation to review such statements whenever requested by the Authority.

### **Next Steps document**

- 4.400. In the next steps document Ofgem stated that this condition should apply to the licences of all NTS and DN-GTs as some of its provisions relate to codes which all NTS and DN-GT licence holders would have in place regardless of whether they supplied domestic customers.
- 4.401. Ofgem noted the concern expressed by a potential purchaser in relation to compliance and detailed that it was Ofgem's understanding that NGT was planning to put relevant statements in place in this regard. As such Ofgem set out that potential purchasers would be able to modify these statements as they saw fit.
- 4.402. As part of the next steps document Ofgem stated that this condition would only change as necessary to refer to the new numbering of current Standard Conditions 18 and 21. In view of these cross-referencing amendments, Ofgem detailed that the provisions of the condition would be placed within a standard special condition in the licences of NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.403. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.404. One potential purchaser accepted the application and drafting of Standard Special Condition A24, and the associated switching off of Standard Condition 22.

*Shippers/suppliers*

- 4.405. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

*DISG comments*

- 4.406. The licence condition drafting for Standard Special Condition A24 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

**Ofgem's proposals**

- 4.407. Ofgem continues to believe that this condition needs to change to reflect necessary cross-reference modifications. In view of these cross-referencing amendments, Ofgem therefore proposes that the provisions of Standard Condition 22 be placed in Standard Special Condition A24 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 22 will then be switched off.
- 4.408. Ofgem invites respondents' views on its proposals for Standard Condition 22. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

***Standard Condition 23 – Record of and Report on Performance***

## **Description**

- 4.409. This condition requires the licensee to keep a record of performance in relation to the general operation of the arrangements referred to in Standard Conditions 18 to 22 and the provision of services to domestic customers. The licensee must publish and provide an annual report on this to the Authority and the Consumer Council.

## **Next Steps document**

- 4.410. In the next steps document Ofgem stated that as this condition is applicable to domestic and non-domestic customers it would not be appropriate to modify the condition in line with NGT's suggestion that it should be amended to only apply to GTs that have one or more domestic customer connected to their network.
- 4.411. Ofgem therefore stated that the only modification to this condition would be to change cross-references to the other conditions as in Standard Condition 22. Ofgem set out that the provisions contained within this condition, with cross-referencing changes, would form a standard special condition in the licences of NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.412. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.413. One potential purchaser accepted the application and drafting of Standard Special Condition A25, and the associated switching off of Standard Condition 23.
- 4.414. Another potential purchaser considered that these reporting obligations should apply separately to each of the RDNs owned by the licensee for comparative regulatory performance purposes. Therefore, this purchaser suggested that this condition should either be amended to reflect this or, alternatively augmented by a special condition that would apply only to the RDNs.



#### *Shippers/suppliers*

- 4.415. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.416. The licence condition drafting for Standard Special Condition A25 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

#### **Ofgem's proposals**

- 4.417. Ofgem continues to believe that the only modification to this condition would be to change cross references to the other conditions as in Standard Condition 22, and that the provisions contained within this condition, with cross referencing changes, be placed in Standard Special Condition A25 applicable to all NTS and DN-GT licensees.
- 4.418. However, Ofgem has noted the comments made by a potential purchaser and has added a provision (in paragraph 6) that makes it clear that the obligations of this condition should apply separately for each DN owned.
- 4.419. The revised drafting for Standard Special Condition A25 is provided for comment in Appendix 8A. Standard Condition 23 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.420. Ofgem invites respondents' views on its proposals for Standard Condition 23. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 24 – Provision of Information to the Authority***

### **Description**

- 4.421. This condition requires that information and reports that the Authority may reasonably require or which may be necessary for it to perform its functions, are provided to the Authority on request. The licensee cannot be required to produce any documents or give any information which it could not be compelled to produce or give in evidence in civil proceedings before a court.

### **Next Steps document**

- 4.422. In the next steps document Ofgem stated that, following its decisions regarding LNG storage and metering services and meter reading services, it proposed that this condition should apply to all NTS and DN-GTs, except insofar as they relate to LNG storage. In this regard Ofgem considered that the LNG Storage provisions should apply only to the NTS-GT. Ofgem also proposed that the metering services and meter reading provisions should apply to all NTS and DN-GTs and set out that there would not be any justification for treating IDN and RDNs differently in respect of such obligations.
- 4.423. Ofgem stated that in order to incorporate changes made to the designated standard condition contained in the amended standard condition in Transco licence that refer to metering services and meter reading services, the provisions in this condition would be set out in a standard special condition in the licences of all NTS and DN-GTs.
- 4.424. To address the issue of LNG, Ofgem further proposed that:
- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
  - ◆ a new NTS special condition should be introduced to “augment” this standard special condition with LNG related provisions (Special Condition C1, paragraph 7).

## **Respondents' views**

### *NGT*

- 4.425. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.426. One potential purchaser accepted the application and drafting of Standard Special Condition A26, and the associated reversion of Amended Standard Condition 24 to a standard condition that is then switched off.
- 4.427. Another potential purchaser could see no reference to “transportation business” in the proposed condition and therefore questioned why it is a defined term. This purchaser also suggested removing the designated storage wording.

### *Shippers/suppliers*

- 4.428. One shipper/supplier questioned the drafting of the paragraph, as metering and meter reading services should be separate from “storage arrangements”.

### *DISG comments*

- 4.429. The licence condition drafting for Standard Special Condition A26 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

## **Ofgem's proposals**

- 4.430. Ofgem has made some detailed drafting changes to reflect the responses received, but overall the proposals are consistent with the next steps document. Ofgem notes the comment of a potential purchaser that the term “transportation business”, whilst defined, is not used. As such, this definition has been removed.

- 4.431. With respect to the treatment of storage provisions in this condition, as it was the definition of “transportation business” that included the designated storage provisions and was augmented for LNG Storage in Special Condition C1. As this definition has now been removed, this condition is no longer augmented by Special Condition C1.
- 4.432. Ofgem therefore proposes that the provisions of Amended Standard Condition 24 be placed, subject to the modifications above, in Standard Special Condition A26 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 24 will then be switched off.
- 4.433. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 24. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 25 – Long Term Development Statement***

### **Description**

- 4.434. Amended Standard Condition 25 is a system planning condition obliging the licensee to produce, and update annually, a statement of the forecast use and development of the high pressure system for the next 10 years. The licensee is obliged to submit a copy of the statement and any revisions to the Authority.

### **Next Steps document**

- 4.435. In the next steps document Ofgem stated that following consideration of respondents’ views, NTS and DN-GTs should be obliged to compile and produce a 10 year statement for their own networks following a direction from the Authority. Ofgem also expressed agreement with the views of some

respondents who considered that it would be important for the NTS-GT to use information from the DNs in compiling its report.

- 4.436. Ofgem proposed that the DN-GTs should be obliged to furnish other GTs with a copy of their statement if directed to do so by the Authority and that the NTS-GT should then be obliged to include information relating to its pipeline system as well as any other pipeline system if directed by the Authority. Ofgem considered that, if such directions were made, this would allow the NTS to use the information contained in the DNs' reports when drafting its report.
- 4.437. Ofgem therefore proposed that a standard special condition should be introduced in the licences of all DN-GTs and a special condition should be introduced in the licences of Transco's NTS-GT containing these provisions as amended in line with Ofgem's proposals.

### **Respondents' views**

#### *NGT*

- 4.438. NGT supported Ofgem's proposals for the NTS and DN-GTs to compile and to produce their own individual 10 year statements for their networks. NGT suggested that the statements should not be "consolidated" in an integrated sense and therefore any requirement for "linkages" between the NTS and DN statements would best be achieved by a series of links to the network operators' websites. NGT did not consider that a firm date within any formula year for publication of the statement was appropriate and stated that this loss of flexibility might have the unintended result of excluding the most recent information from which the industry would benefit.

#### *Potential Purchasers*

- 4.439. One potential purchaser agreed with the application of these conditions and suggested further minor clarifications to clarify the timings involved and to include the same requirements to take into account other systems as in Special Condition C2 in the equivalent paragraph of Standard Special Condition D3, especially in relation to the NTS.
- 4.440. Another respondent suggested removing the designated storage wording.

4.441. Another potential purchaser suggested that there is no recognition in the licence condition that, at least in the short term, the DNs will be reliant on the NTS providing them with data to input into the forecasting process. This potential purchaser also suggested that the condition assumes that the DN statement will be finished, provided to Transco and that then Transco will produce its statement but that, in reality, the two will be produced very much in parallel. This potential purchaser also suggested an additional paragraph should be added to Special Condition C2 to oblige the NTS to provide appropriate information to the licensees of any other pipeline systems as such licensees may reasonably require.

*Shippers/suppliers*

4.442. One shipper/supplier considered that this condition may require adjustment to ensure that the DNs prepare their long term development statements in sufficient time for the NTS to take account of them in preparing the overall long term development statement to the appropriate deadline.

*DISG comments*

4.443. The licence condition drafting for Standard Special Condition D3 and Special Condition C2 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

4.444. At DISG 29, one potential purchaser noted that given the interaction between NTS and DN statements, and stated that it would be useful to include timing requirements within the condition.

4.445. NGT indicated that they would prefer the timing requirement to be removed, but if it were to remain, for it to be confined to quarter 4 for the NTS in any year and quarter 3 for the DNs in any year.

4.446. Following consideration of respondents' views, Ofgem took revised drafting for the NTS and DN long term development statement conditions to DISG 33. At

this meeting, Ofgem presented drafting that reflected a number of modifications that had been made to these conditions, including, but not limited to:

- ◆ provisions in paragraph 1, that would allow the Authority to direct the timing as well as the format of such statements;
- ◆ the removal of the words “high-pressure” in paragraph 1(a), such that lower pressure pipe-lines could be included within the scope of such statements; and
- ◆ the imposition of a reasonable endeavours obligation to keep such statements up to date.

4.447. NGT expressed their concern that under their interpretation this condition would require them to publish literally a street map of all pipes, which would be neither desirable nor logistically possible. They suggested that the practice of providing upon request the details that a party might require in order to connect to a DN's pipes be continued. They also suggested that DNs should publish their own information.

4.448. NGT further noted their concern that paragraph 2 is unclear as to the frequency or timing of statement revision. They considered that the statement should at least be updated according to a periodicity specified in a Direction by the Authority.

4.449. NGT also considered that Ofgem's mooted proposal of requiring DN-GTs to publish (by a separate direction) an increased amount of information about the location and capability of its assets through a long term development statement would be an inefficient way of making this information available and suggest that an obligation to:

- ◆ publish proactively demand forecast information; and
- ◆ provide on request greater detail to parties seeking to connect;
- ◆ would be an efficient and sufficient obligation (as currently).

4.450. NGT were also concerned about the increased risk to security of GT assets and the public that would arise if GTs were required to produce a directory of its

pipes. They recommended that the obligation on the face of the licence be redefined to extend only to the high pressure pipelines within DN networks (as currently).

- 4.451. A potential purchaser indicated that they were uncomfortable with the removal of the high pressure qualification in paragraph 1(a) because, as drafted, this could mean including details of all plans for all pipes on their system which could lead to increases in costs. This potential purchaser stated that, if the term “high pressure” is ambiguous in the opinion of the Authority itself, then they would suggest some other term, or even a qualification that said that, in effect, the level of granularity had to be agreed with the Authority.
- 4.452. This potential purchaser indicated a preference for more clarity upfront, rather than in a subsequent direction, as to the level of detail required here in this condition. They further explained that this was because they were designing new systems, and understanding reporting requirements earlier could minimise subsequent development costs.
- 4.453. Another potential purchaser stated that they did not believe it realistic for the annual statement to be constantly updated throughout the year. More generally, they were concerned that the scope of the obligations associated with this condition are as yet undefined and that any direction provided by the Authority could considerably extend the extent to which information relating to the DNs is provided within NGT’s current long term development statement.

### **Ofgem’s proposals**

- 4.454. Ofgem continues to consider that both NTS and DN-GTs should be required to produce long term development statements. Furthermore, Ofgem continues to believe that co-ordination of statements is important so that a single industry development statement is developed.
- 4.455. Ofgem notes that, in order for such co-ordination to occur, there will need to be some specification of the timing of the release of such documents. However, Ofgem is of the view that it is not appropriate to hard-wire such dates into the licence drafting, but that such timing should be part of the direction issued by the Authority in such a circumstance.



4.456. Ofgem notes that the removal of the “high-pressure” qualification could increase the scope of the long term development statements produced by the DNs. Indeed, Ofgem believes that an increase in scope may be desirable. However, Ofgem would stress that the format of the long term development statements required would be the subject of an Authority direction, and that in making such a direction, the Authority will consider the costs and security implications of that direction.

4.457. In consideration of respondents’ views, Ofgem has made a number of modifications to the licence condition drafting published within the next steps document, including, but not limited to:

- ◆ provisions in paragraph 1, that would allow the Authority to direct the timing as well as the format of such statements;
- ◆ the removal of the words “high-pressure” in paragraph 1(a), such that lower pressure pipe-lines could be included within the scope of such statements as directed by the Authority;
- ◆ the imposition of a reasonable endeavours obligation to keep such statements up to date; and
- ◆ the removal of the designated storage provision wording in Standard Special Condition D3.

4.458. In relation to the obligation to revise statements, Ofgem would note that this is a “reasonable endeavours” obligation and that this should address some of the flexibility concerns raised by NGT with respect to the specification of statement release dates.

4.459. Ofgem therefore proposes that the provisions of Amended Standard Condition 25 be placed, subject to the modifications above, in Standard Special Condition D3 applicable to all DN-GTs, and in Special Condition C2 applicable to the NTS licensee. The revised drafting for these conditions is provided for comment in Appendices 8D and 8C respectively.

4.460. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 25. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section

23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **Related consultation**

- 4.461. Ofgem intends to consult on the form, scope and timing of the statements that the NTS and DN-GTs are required to compile, under the provisions contained within this condition, later this year.

## ***Standard Condition 27 – Adjustments of Amounts by Reference to the Retail Price Index***

### **Description**

- 4.462. Where a standard condition provides for an amount to be adjusted, this condition defines the appropriate adjustment mechanism using the Retail Price Index (RPI).

### **Next Steps document**

- 4.463. In the next steps document Ofgem stated that following consideration of respondents' views and discussions at DISG, it was proposing not to make any modifications to this standard condition so that it would continue to apply to all GT licences including NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.464. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.465. One potential purchaser accepted the application and drafting of Standard Condition 27.

### *Shippers/suppliers*

- 4.466. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.467. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.468. Ofgem continues to propose not to make any modifications to this standard condition so that it will continue to apply to all GT licences including NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.
- 4.469. Ofgem invites respondents' views on its proposals for Standard Condition 27. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 28 – Termination of Shipping Arrangements***

### **Description**

- 4.470. Standard Condition 28 requires the licence holder to keep relevant suppliers informed about the terms which are specified for the purposes of Standard Condition 24B of their gas suppliers' licences (Undertakings to be Given by Licensee to Relevant Transporters in Respect of Shipping Charges etc).

### **Next Steps document**

- 4.471. In the next steps document Ofgem considered that it would be appropriate not to make any modifications to this condition so that Standard Condition 28 would apply to all GT licensees including NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.472. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.473. One potential purchaser accepted the application and drafting of Standard Condition 28.

#### *Shippers/suppliers*

- 4.474. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.475. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.476. Ofgem continues to consider that it would be appropriate not to make any modifications to this condition so that Standard Condition 28 would apply to all GT licensees including NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 7.
- 4.477. Ofgem invites respondents' views on its proposals for Standard Condition 28. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process,

which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 29 – Disposal of Assets***

### **Description**

- 4.478. This condition provides that the licensee must not dispose of, or relinquish operational control over, any transportation asset or LNG Storage asset otherwise than in accordance with this condition.
- 4.479. It sets out that a licence holder is required to give the Authority no less than two months' prior written notice of its intent to dispose of, or relinquish operational control over, any transportation asset or LNG Storage asset together with any further information relating to the transaction that the Authority may request.
- 4.480. Where a transportation asset comprises a significant part of an independent system operated by the licensee, the licensee must, save where the Secretary of State consents otherwise, not dispose of the asset or its right to operate the asset until it has put in place or secured suitable alternative arrangements.
- 4.481. The licensee may dispose of or relinquish operational control over a transportation or LNG Storage asset where the Authority has issued a direction containing a general consent to the transaction, disposal or relinquishment of a specified asset and the disposal is in accordance with any conditions to which the consent is subject or where the disposal is required by legislation.

### **Next Steps document**

- 4.482. In the next steps document Ofgem stated that it would be important to retain the same degree of regulatory control over network owners and their ability to dispose of assets or relinquish control over them after any DN sales as is in place currently.
- 4.483. Ofgem set out that it was still considering the point raised by one respondent, that the passing over of control centre activities to DNs by NGT at the time at

which the System Operation Service Management Agreements (SOMSAs) expire could be interpreted as relinquishing operational control of an asset when the transaction is completed. Ofgem detailed that it would consult with the DISG on this issue, if necessary.

4.484. Ofgem therefore proposed that the provisions contained in this amended standard condition should be placed in a standard special condition applicable to all NTS and DN-GTs. Ofgem explained that further changes to this drafting would be required to reflect Ofgem's proposal to retain an equivalent level of regulatory control following a potential DN sale and set out that this revised drafting would be issued to the DISG for consultation prior to publication of the formal Section 8AA notice.

4.485. To address the issue of LNG, Ofgem further proposed that:

- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS special condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 8).

4.486. Ofgem noted that the provisions with respect to independent networks had been retained in this condition but that the future treatment of Special Condition 18 was being considered by the DTI, and that any necessary changes would need to be reflected within Standard Special Condition A27 as appropriate.

### **Respondents' views**

*NGT*

4.487. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.488. One potential purchaser accepted the application and drafting of Standard Special Condition A27, and the associated reversion of Amended Standard Condition 29 to a standard condition that is then switched off.
- 4.489. Another potential purchaser suggested removing the designated storage wording.

#### *Shippers/suppliers*

- 4.490. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.491. The licence condition drafting for Standard Special Condition A27 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 4.492. At DISG 33, revised drafting of Standard Special Condition A27 was discussed. These revisions were draft modifications that considered the small changes that may be necessary to Standard Special Condition A27 given provisional DTI proposals with respect to the treatment of independent systems.
- 4.493. One potential purchaser stated that while they did recognise that the relevant legal instrument (the alternative arrangements referred to in this condition) was for the DTI to develop, it would be helpful to have sight of it sooner rather than later.
- 4.494. Another potential purchaser continued to have concerns associated with the future treatment of the independent systems, the DTI Direction and the removal of Special Condition 18. This potential purchaser also suggested that the drafting of paragraph 2A(b) should be amended to reflect the fact that it will be the acquirer of the independent system that will be required to comply with the "alternative arrangements".

## Ofgem's proposals

- 4.495. Ofgem continues to consider that it is important for it to retain the same degree of regulatory control in relation to these issues. Ofgem is therefore continuing to propose, consistent with the next steps document, that a standard special condition is introduced into the licences of all NTS and DN-GTs concerning disposal of assets.
- 4.496. Ofgem notes the comments from one potential purchaser concerning the SOMSAs. Ofgem considers that paragraph 1 of this condition which states that “the licensee shall not dispose of the relinquishment operation control over any transportation asset unless in accordance with this condition” is very clear regarding the requirements of the licensee. Ofgem considers that it is the responsibility of licensees to reach a judgement regarding the SOMSAs and whether they could be viewed as a relinquishment of operational control. Obviously if the licensee were to reach the conclusion that SOMSAs represented a relinquishment of operational control the licensee could apply for the Authority's consent. Failure to comply with any licence condition could result in enforcement action and possibly could result in a financial penalty of up to 10% of turnover.
- 4.497. As discussed in Chapter 3, Ofgem also proposes to implement amendments within Standard Special Condition A27 to reflect the DTI's proposals with respect to the treatment of independent systems. The DTI has issued a position paper in this regard which details that the provisions currently incorporated within Special Condition 18, relating to independent systems, will sit outside of the licence but that the licence will retain various references in relation to these provisions. Furthermore, the DTI published its proposed alternative arrangements within annexes of its “Statement of Reasons” document which was published on 14 February 2005.<sup>34</sup> This is discussed in greater detail in Chapters 2 and 3, and a copy of the DTI position paper is provided for information in Appendix 9.

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<sup>34</sup> [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)



4.498. Given the DTI's proposals with respect to independent systems, the following modifications have been made to Standard Special Condition A27 relative to the draft of the condition published in the next steps document:

- ◆ references to Special Condition 18 have been removed;
- ◆ paragraph 2A has been amended such that consent to the disposal of the independent system assets will only be required with respect to independent systems that remain independent from the GB system;
- ◆ paragraphs 2A (b) and (c) have been amended to bind purchasers to any alternative arrangements determined by the Secretary of State; and
- ◆ definitions of "alternative arrangements", "appointed day" and "relevant premises" have been introduced for clarity.

4.499. Furthermore, to reflect Ofgem's proposed treatment of storage provisions, the designated storage provisions and all "storage asset" references have been removed from the drafting of Standard Special Condition A27. This condition is then augmented by paragraph 7 of NTS Special Condition C1 to introduce LNG storage obligations.

4.500. Ofgem proposes that the provisions of Amended Standard Condition 29 be placed, subject to the modifications above, in Standard Special Condition A27 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A.

4.501. Ofgem invites respondents' views on its proposals for Amended Standard Condition 29. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 30 – Regulatory Accounts***

### **Description**

4.502. Amended Standard Condition 30 sets out the obligations on the licence holder as regards its regulatory accounts. It includes the duty to produce separate annual regulatory accounts in respect of each of its separate businesses and to provide copies of these to the Authority.

### **Next Steps document**

4.503. As set out in Chapter 3, in the next steps document Ofgem stated that, consistent with the majority of respondents, it considered that its initial proposals regarding this condition would continue to be appropriate.

4.504. Ofgem proposed that the provisions set out in this amended standard condition should be modified to ensure the submission of regulatory accounts for each separate RDN business and should then be placed in a standard special condition applicable to all NTS and DN-GTs.

4.505. Ofgem noted however that changes to the drafting may be required to reflect developments occurring through the DPCR 4 process. In this regard Ofgem set out that the requirement to produce current costs regulatory accounts and an unaudited interim regulatory profit and loss account was being revised through the DPCR 4 process. Ofgem stated that it considered that regulatory reporting licence conditions should be consistent across all regulated businesses and that following the DPCR 4 consultation, the regulatory accounts reporting requirements may be amended to:

- ◆ remove the requirement to produce current costs regulatory accounts and an unaudited interim regulatory profit and loss account;
- ◆ update the regulatory accounts format in line with the most recent changes to companies legislation; and
- ◆ require the auditors to move to a “fairly presents” opinion instead of a “true and fair view” opinion.

4.506. To address the issue of LNG, Ofgem further proposed that:

- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS special condition should be introduced to “augment” this standard special condition with LNG related provisions (Special Condition C1, paragraph 9).

4.507. Ofgem clarified that it would be necessary to consider this condition to ensure intra-company dealing would be appropriately treated between Transco’s NTS and RDNs. Ofgem set out that as Transco’s NTS and DN businesses would be internal business units of a single company it would not be subject to provisions regarding intra-company dealings.<sup>35</sup> Ofgem therefore considered that it may be necessary to make further changes to this condition to ensure that Transco’s RDNs are required to maintain accounting and reporting records that permit the Transco NTS licensee to fulfil its obligations (and vice versa).

### **Respondents’ views**

#### *NGT*

4.508. NGT acknowledged that regulatory accounts are Ofgem’s main source of information about regulated businesses. NGT therefore accepted that Ofgem needs to ensure that the information that Ofgem will obtain is the right information for comparative and policing purposes. NGT recognised 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.

#### *Potential Purchasers*

4.509. Two potential purchasers supported the proposals for regulatory accounts. One of these respondents supported the potential proposals to remove the current

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<sup>35</sup> Similarly, Transco NTS and RDNs would not be subject to the provisions of paragraph 9 of Special Condition C1 (the amended NTS version of paragraph 1 of Standard Condition A30) for intra-company dealings.

cost accounts requirement and the interim unaudited profit and loss account, to update the format of the regulatory accounts and to move to a “fairly represents” audit opinion. To maintain transparency, this potential purchaser considered that the “fairly represents” opinion for NGT should not be for the licensed business as a whole, but should be separately required for each DN and the NTS. This potential purchaser also suggested that it would be helpful for Regulatory Accounting Guidelines consistent with the draft condition to be developed and issued as soon as possible.

- 4.510. One potential purchaser agreed that it would be appropriate to bring the regulatory accounts requirements into line with the equivalent electricity distribution requirements that are currently being consulted upon.
- 4.511. Two potential purchasers suggested that IDNs should not be required to produce stand-alone regulatory accounts for metering activities. One of these potential purchasers suggested that the drafting of this condition is more relevant to Transco in that it has an established regulated meter and meter reading business. Therefore, this potential purchaser considered that it would be appropriate for the Authority to have the power to derogate the regulatory accounting requirements in respect of the activities listed in (b) and (c) and that to this end, paragraph 1 should begin “Unless the Authority otherwise consents ...”.
- 4.512. One potential purchaser agreed with Ofgem that this condition must make sure that separate regulatory accounts are prepared in respect of each of NGT’s four RDNs and that the RDNs should be subject to more stringent reporting requirements than the IDNs to capture the intra-company dealings. This potential purchaser considered that this was particularly important to ensure that comparative regulation is not compromised by NGT not being required to legally separate its NTS and DN businesses. Therefore this potential purchaser considered that this condition should be augmented by special conditions that would apply to both the NTS and the RDNs. This potential purchaser also suggested that it would be important to ensure that costs are appropriately allocated and reported between RDNs to ensure that comparative regulation is not compromised.

### *Shippers/suppliers*

- 4.513. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.514. The licence condition drafting for Standard Special Condition A30 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 34 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 4.515. One potential purchaser reiterated concerns regarding the provision of regulatory accounts by IDNs for their metering businesses. This respondent stated that the provision in paragraph 14 should be widened to consider not only the extent of competition but the respective turnover of the licensees metering and meter reading businesses. This would give flexibility to establish alternative more appropriate reporting arrangements for businesses with very small turnovers.
- 4.516. Another potential purchaser questioned whether it is within an auditor's competence to comment on compliance with European Directives. They noted that the equivalent electricity licence condition (Standard Condition 42 paragraph 6) had been changed to reflect this, and therefore believed that this standard special condition should be brought into line.

### **Ofgem's proposals**

- 4.517. Following consideration of respondents' views, as expressed within formal responses to the next steps document, comments from DISG members, and comments received in relation to the DPCR 4 consultation, Ofgem has incorporated the drafting of the equivalent condition proposed for the electricity distribution companies, with additional modifications to reflect different circumstances in the gas sector.
- 4.518. In finalising the common elements to this condition, a number of modifications have been made to the draft consulted upon as part of the DPCR 4 consultation

to reflect respondents' views with respect to issues, such as those raised above in relation to the competence of auditors.

4.519. However, as stated above, it has been necessary to make a number of additional modifications to the standard drafting to reflect gas industry specific factors.

These are that:

- ◆ the businesses for which regulatory accounts are required are necessarily different; and
- ◆ modifications have been required to reflect the fact that the two Transco licences sit within the same legal entity, which, in turn, has only one set of statutory accounts.

4.520. In terms of the businesses for which regulatory accounts must be provided, these are:

- ◆ the transportation business (which in the case of the NTS or the IDN businesses, relates only to that element of the business, and in the case of the RDN business must be provided for each distribution network);
- ◆ the LNG storage business, in the case of the NTS, with this provision being inserted by means of paragraph 8 of NTS Special Condition C1;
- ◆ the metering business, separately identifying the meter provider of last resort services for each distribution network;
- ◆ the meter reading business;
- ◆ the de minimis business of the licensee;
- ◆ other activities for which the Authority has granted consent under paragraph 3(d) of Standard Special Condition A36, separately identifying the apportionment of each such activity to each of the businesses above; and
- ◆ for the whole business to which the licence relates and, in addition, details of any de minimis business carried out by a relevant associate of the holder of the licence.

- 4.521. The penultimate bullet above introduces reporting requirements for the new activities and services between GT businesses that will arise as a result of DN sales. As discussed with respect to Standard Special Condition A36, later in this chapter, and in Chapters 3 and 5. Ofgem is no longer proposing to augment the de minimis cap in Standard Special Condition A36, but rather to exempt such activities from the definition of de minimis, provided that appropriate reporting requirements are in place.
- 4.522. It is noted that paragraph 1 requires the preparation of the regulatory accounts identified unless the Authority consents otherwise. Transco is currently structured into three businesses: the NTS business, the RDN business and the metering business. For the purposes of its regulatory accounts submission, Ofgem therefore envisages granting Transco consent to provide regulatory accounts as part of its RDN licence submission and not as part of its NTS licence submission.
- 4.523. The status of Transco holding two licences with one business has also required the insertion of an additional paragraph. Paragraph 1A has been inserted such that, in the event that a single legal entity holds licences for more than one relevant gas transporter, reconciliation information should be provided to allow the different regulatory accounts submitted under different licences to be reconciled to the statutory accounts. This paragraph provides further guidance that the different regulatory accounts, do not overlap, and that no cost items are omitted from one or other set of regulatory accounts.
- 4.524. It should be noted that where appropriate, existing provisions of Amended Standard Condition 30, have been incorporated into Standard Special Condition A30 (as shown in sub-paragraphs (aa) to (cc) of 3(b)(viii), and paragraphs 4, 5, 12 and 15 of the drafting provided in Appendix 8A).
- 4.525. Additional modifications include, but are not limited to, the following:
- ◆ a requirement for the reconciliation information provided under paragraph 1A to be published;
  - ◆ an exemption from publication for the existing de minimis activities represented by paragraph 1(e) and any other information agreed to be confidential by the Authority; and

- ◆ insertion of definitions for “de minimis” and “relevant associate”.

4.526. As stated above, where appropriate, the provisions of Standard Special Condition A30 are augmented to provide for provision on LNG Storage by paragraph 8 of Special Condition C1.

4.527. Ofgem therefore proposes that the provisions of Amended Standard Condition 30 are replaced with provisions that create greater standardisation across network licences within Standard Special Condition A30 applicable to all NTS and DN- GTs. The revised drafting for this condition is provided for comment in Appendix 8A.

4.528. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 30. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 30A – Change of Financial Year***

### **Description**

4.529. Where the licensee changes its financial year in relation to its statutory accounts, it must provide notice to the Authority specifying the new dates for the current and subsequent financial years which will continue in force unless revoked by the licensee by further notice.

### **Next Steps document**

4.530. In the next steps document Ofgem stated that it would be appropriate not to propose any modifications to this condition so that Standard Condition 30A would continue to apply to all GT licences including NTS and DN-GTs.

4.531. However, as set out in Chapter 3, Ofgem noted that changes may be required to this condition to reflect developments occurring through the DPCR 4 process, in particular relating to the regulatory accounts provisions.



## **Respondents' views**

### *NGT*

- 4.532. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.533. One potential purchaser accepted the application and drafting of Standard Condition 30A.

### *Shippers/suppliers*

- 4.534. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.535. Following publication of the next steps document, Ofgem stated that it proposed to bring the drafting of Standard Condition 30A into line with that proposed for electricity distribution licences as a result of the DPCR 4 consultation process.
- 4.536. As a result, revised drafting of this condition was presented at DISG 34, consistent with the DPCR 4 proposals. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during this meeting and by written responses after this meeting. The minutes of these meetings are attached in Appendix 2.

## **Ofgem's proposals**

- 4.537. Ofgem proposes to adjust the Change of Financial Year condition so that it is consistent with the equivalent condition within the electricity DNO licences following the recent DPCR 4 consultation. Ofgem therefore proposes to switch off Standard Condition 30A and reinstate it as Standard Special Condition A29 applicable to all NTS and DN-GTs.
- 4.538. The main change to the change of financial year obligations upon Transco is the removal of the obligation to prepare and deliver audited group accounts to the

Authority (i.e. the provisions of paragraphs 4 and 5 of Standard Condition 30A have been removed).

- 4.539. In addition to the standard drafting for this condition, an additional paragraph (paragraph 6) has been added to clarify that, for the purposes of this condition, references to “licensee” shall mean the legal entity that holds the licence concerned, i.e. Transco rather than Transco’s NTS or RDN businesses. This is necessary because this condition relates to the financial year applied within statutory accounts, and statutory accounts will only be produced at a Transco plc level.
- 4.540. Ofgem invites respondents’ views on its proposals for Standard Condition 30A. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.
- 4.541. Ofgem would note that, to the extent to which any inconsistencies remain between the DNO and GT licences with respect to this condition, these may be corrected as part of a further section 23 process subsequent to hive-down. The revised drafting for this condition is provided for comment in Appendix 8A.

## ***Amended Standard Condition 31 – Supply Point Administration Services***

### **Description**

- 4.542. Amended Standard Condition 31 obliges the licensee to establish, operate and maintain an information service with a register that provides information regarding the identity of the relevant gas shipper, the type of equipment installed and an accurate address of all domestic premises. This condition also contains an obligation to provide information on gas pressure for parties who may require connecting pipelines and other information as needed.

## **Next Steps document**

- 4.543. In the next steps document Ofgem stated that following consideration of respondents' views on this condition it considered that the provisions of Standard Condition 31 should apply to all GTs following DN sales. Ofgem was of the opinion that these provisions should apply regardless of whether there were domestic customers connected to the licensee's network as they relate to both domestic and non-domestic customers.
- 4.544. Ofgem therefore proposed that the provisions contained in Amended Standard Condition 31 should be set out in a standard special condition applicable to all NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.545. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

### *Potential Purchasers*

- 4.546. One potential purchaser accepted the application and drafting of Standard Special Condition A31, and the associated reversion of Amended Standard Condition 31 to a standard condition that is then switched off. This potential purchaser suggested it might be appropriate to include a cross-reference to the Agency.

### *Shippers/suppliers*

- 4.547. One shipper/supplier considered that this condition be amended to make explicit the requirement that the Supply Point Administration Service that is provided or procured under this condition should be a single service covering all DN and NTS networks. This shipper/supplier suggested that this would be both more convenient for users and reduce the risk of data quality degradation over time.

### *DISG comments*

- 4.548. The licence condition drafting for Standard Special Condition A31 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.

### **Ofgem's proposals**

- 4.549. Following consideration of respondents' views, Ofgem has inserted additional wording into paragraph 1 such that the agency condition (Standard Special Condition A15) is referenced to clarify that such obligations should be met through the agency.
- 4.550. Ofgem therefore proposes that the provisions of Amended Standard Condition 31 be placed, subject to the modifications above, in Standard Special Condition A31 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 31 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.551. Ofgem invites respondents' views on its proposals for Amended Standard Condition 31. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 32 – Interpretation of Section C***

## **Description**

- 4.552. This condition sets out the definition of “permitted purpose” activities which, through the operation of other conditions, the licensee is authorised to pursue in the conduct of its business.
- 4.553. Permitted purpose is used to define the scope of the obligations set out in Section C of the standard conditions of the licence and certain special conditions. Amended Standard Condition 32 in Transco’s licence defines “permitted purpose” as including Transportation and LNG storage business, meter business and meter reading business.

## **Next Steps document**

- 4.554. In the next steps document Ofgem set out that it had decided that provisions related to metering and meter reading should sit within the licences of all NTS and DN-GTs. As such, Ofgem stated that it would be necessary for the Amended Standard Condition 32 (insofar as it relates to these activities) to apply to all NTS and DN-GT licensees.
- 4.555. Ofgem therefore proposed that the provisions contained in Amended Standard Condition 32, other than those relating to LNG storage, should be placed in a standard special condition applicable to all NTS and DN-GTs.
- 4.556. To address the issue of LNG, Ofgem highlighted that a new NTS special condition would be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 9).
- 4.557. Ofgem stated that further consideration would need to be given to whether there was a need to modify the definition of permitted purposes within the NTS and RDN licences to reflect business separation. Ofgem detailed that it would take its proposals, in this area, to DISG.

## **Respondents’ views**

*NGT*

- 4.558. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.559. One potential purchaser accepted the application and drafting of Standard Special Condition A32, and the associated reversion of Amended Standard Condition 32 to a standard condition that is then switched off.
- 4.560. Another potential purchaser noted that Ofgem intends to make further alterations to this proposed drafting to clarify distinctions between NTS and RDN transportation businesses and suggests that the reference to “this Section of the standard conditions” needs to be amended.

### *Shippers/suppliers*

- 4.561. One shipper/supplier suggested that paragraph 1 may need amending to reflect the fact that it refers to standard special conditions rather than standard conditions.

### *DISG comments*

- 4.562. The licence condition drafting for Standard Special Condition A32 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

### **Ofgem’s proposals**

- 4.563. Ofgem continues to believe that provisions related to metering and meter reading should sit within the licences of all NTS and DN-GTs. As such, Ofgem proposes that the amended version of this condition (insofar as it relates to these activities) should apply to all NTS and DN-GTs.
- 4.564. After further consideration, Ofgem has decided that it is not necessary to amend further Standard Special Condition A32 to reflect the business separation of Transco’s NTS and RDN businesses. This is because, as discussed earlier in this chapter, the definition of “transportation business” within Standard Special Condition A3 has been clarified such that it is clear that this relates only to the NTS or RDN businesses as appropriate.

- 4.565. Further modifications have been made to correct minor editorial errors highlighted by respondents. Furthermore, it should be noted that the provisions of this condition are augmented by paragraph 9 of NTS Special Condition C1 to reflect the fact that the LNG Storage business falls within the definition of permitted purpose for the NTS business.
- 4.566. Ofgem therefore continues to propose that the provisions contained in Amended Standard Condition 32, other than those relating to LNG Storage, be placed, subject to the modifications above, in a standard special condition (Standard Special Condition A32 – Definition of Permitted Purpose) applicable to all NTS and DN-GTs. The revised drafting for Standard Special Condition A32 is provided for comment in Appendix 8A. Amended Standard Condition 32 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.567. Ofgem invites respondents' views on its proposals for Amended Standard Condition 32. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 33 – Designated Registrar of Pipes***

### **Description**

- 4.568. The Authority may, by notice, designate the licensee as the “designated registrar of pipes”, obliging it to establish, maintain and operate or procure the establishment, operation and maintenance of a service to be known as the Main Administration Service within the area described in the designation notice.
- 4.569. There is currently no designated registrar of pipes. The condition is included in Transco's existing GT licence, but requires a direction from the Authority, following consultation, in order for Transco to be obliged to comply with it.

## **Next Steps document**

- 4.570. In the next steps document Ofgem considered that it would be appropriate for Standard Condition 33 to apply to all NTS and DN-GTs as this would provide the Authority with the flexibility to appoint a registrar of pipes should this be considered appropriate. Ofgem therefore stated that Standard Condition 33 would remain unchanged, and continue to apply to all GT licensees including all NTS and DN-GTs.
- 4.571. Ofgem explained that it had not reached a decision as to whether the Authority would be exercising its powers to appoint such a registrar(s) as part of the DN sales process, but that it would carry out a full consultation before deciding to make any such direction. Ofgem also set out its intention to discuss these conditions at a future DISG meeting.

## **Respondents' views**

### *NGT*

- 4.572. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.573. One potential purchaser accepted the application and the drafting of Standard Condition 33 but considered that it is not necessary to appoint a registrar of pipes for the time being.

### *Shipper/supplier*

- 4.574. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.575. Following further consideration of the impact of DN sales upon the licence conditions within Transco's existing licences, Ofgem came to the view that both Standard Condition 5A (Information to be Provided to the Designated Registrar of Pipes) and Standard Condition 33 (Designated Registrar of Pipes) as drafted only recognised the possibility of there being only one designated registrar of



pipes. As a result, Ofgem brought revised drafting of these conditions to DISG 34 which acknowledged the possibility of more than one designated registrar of pipes within Standard Special Condition A49 (Designated Registrar of Pipes) and Standard Special Condition A50 (Information to be Provided to a Designated Registrar of Pipes). However, following this DISG meeting, Ofgem is now proposing to switch off Standard Condition 5, and as such, Standard Condition 5 will become Standard Special Condition A50, and Standard Condition 5A will become Standard Special Condition A51 (Information to be Provided to a Designated Registrar of Pipes).

4.576. The licence condition drafting for Standard Special Condition A49 was discussed at DISG 34. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

4.577. NGT reiterated earlier comments to Ofgem that they considered the designation of any gas transporter as a registrar of pipes to be unnecessary, with potential for adverse safety implications and likely inefficiencies.

### **Ofgem's proposals**

4.578. Following further consideration of the issues associated with the designated registrar of pipes Ofgem has altered its proposals for the next steps document. Ofgem considers that the designated registrar of pipes provisions should be contained with all NTS and DN-GT licences.

4.579. Furthermore, as stated above, Ofgem considers that it is appropriate for the existing licence condition to be amended as part of the DN sales process, to reflect the potential existence of more than one designated registrar of pipes. Although Ofgem understands from Transco that the FOMSA provides for the existing voluntary arrangement to continue in the short term, Ofgem considers it is appropriate for the licence to be amended to reflect change of DN ownership to enable Ofgem to appoint one or more DNs as designated registrars of pipes, if required.

4.580. The question of whether the Authority would issue a direction, activating the designated registrar of pipes provisions of the licence, would be considered in

conjunction with Standard Special Condition A49. Ofgem proposes to consult on these issues concerning the designated registrar of pipes in February 2005

- 4.581. Ofgem therefore proposes that the provisions of Standard Condition 33 be placed, subject to the modifications above, in Standard Special Condition A49 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 33 will then be switched off.
- 4.582. Ofgem invites respondents' views on its proposals for Standard Condition 33. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 38 – Availability of Data Formats***

### **Description**

- 4.583. Where a licensee uses standard file formats for transferring data for any purpose set out in the licensee's network code, it is required to make those standard file formats and associated definitions of data available free of charge to shippers and GTs for use in connection with their licensed activities.

### **Next Steps document**

- 4.584. In the next steps document Ofgem stated that following development of the proposals regarding the UNC, since the September document was published, Ofgem considered that it would be appropriate for the standard form of this condition to apply to all NTS and DN-GT licence holders. Ofgem also stated that the wording contained in this condition would offer sufficient flexibility to ensure that the relevant file formats could be shared with relevant persons subject to the drafting of the Network Code.<sup>36</sup>

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<sup>36</sup> Ofgem is currently consulting on proposed modifications to this condition. Any such changes to the

## **Respondents' views**

### *NGT*

- 4.585. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.586. One potential purchaser accepted the application and the drafting of Standard Condition 38.

### *Shippers/suppliers*

- 4.587. One shipper/supplier considered that the obligations under this standard condition should be extended to include the common systems obligation referenced in the standard special conditions to extend the common systems obligation to the IGTs.

### *DISG comments*

- 4.588. The issue of achieving commonality of data formats was raised by a number of DISG members. At DISG 33 it was discussed as to whether it would be appropriate to include an additional clause within the licence condition regarding the need for common communications and data formats. One potential purchaser stated that such a clause would be necessary in order to address concerns that affected parties have expressed regarding the divergence of data formats. NGT stated that it was intending to include common data formats as part of the Common Services Agreement (CSA) and so anticipated that this should not be a problem. The minutes of these meetings are attached in Appendix 2 for information.

## **Ofgem's proposals**

- 4.589. Following consideration of respondents' views, Ofgem continues to consider that it would be appropriate for the standard form of this condition to apply to all NTS and DN-GT licence holders. Whilst Ofgem continues to believe that the

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Designated Standard Condition that take effect prior to the Section 8AA consent process will need to be

wording contained in this condition will offer sufficient flexibility to ensure that the relevant file formats can be shared with relevant persons subject to the drafting of the Network Code<sup>37</sup>, following consideration of respondents' views, Ofgem proposes to introduce an additional sub-paragraph 1(b) such that the licensee's obligations under the Network Code and the Agency Services (AS) agreement are referenced.

- 4.590. Ofgem therefore proposes that the provisions of Standard Condition 38, subject to the modifications above, be placed in Standard Special Condition A14 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 38 will then be switched off.
- 4.591. Ofgem invites respondents' views on its proposals for Standard Condition 38. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Amended Standard Condition 39 – Restriction on Use of Certain Information and the Independence of the Transportation Business***

#### **Description**

- 4.592. Amended Standard Condition 39 prevents the flow of information between the transportation business, the trading business, and pursuant to the changes brought about through the RGMA process, the licensee's meter-related services business and meter reading business.

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taken into consideration.

<sup>37</sup> Ofgem is currently consulting on proposed modifications to this condition. Any such changes to the Designated Standard Condition that take effect prior to the Section 8AA consent process will need to be taken into consideration.

- 4.593. The condition obliges the licensee to use its best endeavours to secure that no information related to, or derived from, its transportation business is disclosed for the purposes or benefit of its trading business, its meter related services business, its meter reading business or any affiliate or related undertaking of the licensee.
- 4.594. In this licence condition the transportation business includes LNG Storage arrangements but the Authority has the ability to omit these provisions through the procedures contained within this condition.

### **Next Steps document**

- 4.595. In the next steps document Ofgem stated that it considered that it would be appropriate to update the business separation requirements to align the gas business separation requirements to align them with those that apply in electricity. Ofgem also considered that it would be necessary to introduce new special conditions applicable to Transco's NTS and RDN businesses to ensure no undue discrimination between their network businesses.
- 4.596. In this regard Ofgem set out that this condition should be switched off and replaced with a new standard special condition (A33) reflecting the arrangements for electricity DNOs in terms of preventing preferential dealings between NTS and DN-GTs and their affiliated shipping or supply businesses.
- 4.597. Ofgem noted that Amended Standard Condition 39 contains certain additional provisions relating to storage and metering which have no equivalent within the electricity DNO regime and that, in making the proposed changes, it would be important to accommodate these arrangements.

### **Respondents' views**

#### *NGT*

- 4.598. NGT considered that the proposed Standard Special Condition A33 as drafted would require Transco to prevent various people, including its meter-related services business, from having access to confidential information (e.g. information regarding pressure etc. and data-loggers). NGT was concerned that there is no provision for Ofgem to consent to Transco passing confidential information to any class of prohibited recipient (as currently exists).

- 4.599. NGT stated that if this is not addressed Transco (itself or through an affiliate) and other relevant GTs would be unable to conduct the Industrial and Commercial (I&C) meter business. Furthermore Transco would be forced to cease to provide the transitional services agreed as part of the Review of Gas metering Arrangement (RGMA) process.
- 4.600. Transco also suggested that exceptions from the definition of confidential information currently contained in Amended Standard Condition 39 should be included in Standard Special Condition A33 in order to preserve an appropriate limitation on the definition of confidential information. NGT argued that it is not reasonable or appropriate to prevent disclosure of information where the shipper or supplier (in effect the owner of the information) consents to such information being disclosed.

*Potential Purchasers*

- 4.601. One potential purchaser accepted that this is a potentially complex area but that subject to that outcome of issues of NGT business separation, the potential purchaser accepted the application and the drafting of Standard Special Condition A33 and the associated reversion of Amended Standard Condition 39 to a standard condition that is then switched off.
- 4.602. One potential purchaser supported the replication of equivalent business separation requirements used in the electricity distribution licences and suggested that these conditions are sufficiently robust. This potential purchaser expressed the opinion that the words “an electricity or gas supply licence or” should be deleted from the definition of “relevant shipper”. This potential purchaser also agreed with Ofgem’s view that it will be necessary to ensure that this condition is compatible with the proposed exemption order. This potential purchaser also noted that, as proposed, the approved statement would be placed on its company’s website within 5 working days. This potential purchaser suggested that this condition be aligned with the 15 day electricity requirement.
- 4.603. Another potential purchaser suggested that the application of this condition needed to be considered separately in relation to each of the potential owners of the IDNs and the RDNs. This respondent suggested that, in the case of the Northern DN, none of the potential owners holds supply or shipping licences in

the UK and where similar situations occur in electricity distribution Ofgem has consented to the switching off of this condition for those licensees.

- 4.604. This potential purchaser noted that paragraph 2 defines the systems that a licensee has to put in place in relation to confidential information to ensure a relevant supplier and relevant shipper must not have access to confidential information unless it is made available on an equal basis to any gas or electricity supplier or gas shipper. However, this potential purchaser considered that information is not available currently on an equal basis to gas and electricity suppliers as, for example, Supply Point Administration (SPA) information would not be made available to electricity suppliers.
- 4.605. This potential purchaser also highlighted the apparent contradiction that the clarification of transportation business includes the licensee's metering business but excludes its meter-related services business. However meter-related services business was defined to mean the same thing as the metering business.

#### *Shippers/suppliers*

- 4.606. One shipper/supplier believed that further consideration should be given to the position of companies involved in competitive and regulated activities covering both gas and electricity markets, to ensure adequate separation is taking place and suggested that this should be monitored on an ongoing basis by Ofgem.
- 4.607. Another shipper/supplier noted that this condition may need amendment to encompass holders of generation licences which are affiliated or related undertakings of the licensee.

#### *DISG comments*

- 4.608. The licence condition drafting for Standard Special Condition A33 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.609. NGT stated that there is currently no provision for Ofgem to consent to Transco passing confidential information to any class of prohibited recipient (as currently

exists). They added that if this is not addressed, the consequence will be that Transco (itself or through an affiliate) and other GTs would be unable to conduct their I&C meter business. Furthermore, Transco would be forced to cease to provide the transitional services agreed as part of the RGMA process. In order to solve this problem, they suggested that the restriction on the passing of confidential information in Standard Special Condition A33 should be subject to a “save where the Authority otherwise consents” provision. Furthermore, they suggested that the exceptions from the definition of confidential information contained in paragraphs 2(b), 2(c) and 2(d) of the current Amended Standard Condition 39 should be included in Standard Special Condition A33 in order to preserve an appropriate limitation on the definition of confidential information.

4.610. NGT also commented that sub-paragraph 2(c) of the equivalent electricity distribution condition was unclear as to what information would class as “corporate”.

4.611. In commenting upon the drafting of the new business separation conditions proposed, as discussed in Chapter 5, NGT stated that the obligations to ensure compliance with the statement should be consistent across competitive/monopoly business separation conditions and NTS-RDN separation conditions. When commenting upon the same NTS-RDN business separation conditions, one potential purchaser stated that the obligation upon Transco in this regard should be a “best endeavours” obligation.

### **Ofgem’s proposals**

4.612. Overall, Ofgem continues to believe it is appropriate to align the competitive market/monopoly business separation provisions across network businesses. Following consideration of respondents’ views, a number of modifications have been made to the drafting of Standard Special Condition A33 to correct errors in the drafting published as part of the next steps document and to reflect respondents’ wider comments.

4.613. Following consideration of respondents’ views, the drafting proposed for Standard Special Condition A33 has been modified relative to the equivalent electricity distribution provisions in four ways:



- ◆ in response to NGT's concerns regarding the enduring consent, the drafting of paragraph 2(a) of Standard Special Condition A33 has been amended to insert the words "or any meter asset manager (bearing the meaning of that expression contained in Standard Special Condition A10 (Provision and Supply of Meters)), as requested by NGT;
- ◆ sub-paragraph 2(c) of the electricity drafting has been deleted, due to the lack of clarity in the drafting of this sub-paragraph with respect to "corporate" information, and replaced with the words "unless the Authority otherwise consents in writing" to address NGT's concerns on transitional consent, and allow for the possibility of derogations being granted by the Authority;
- ◆ paragraph 7 has been modified to oblige the licensee to revise their statement should their circumstances change; and
- ◆ the obligation to comply with the statement in paragraph 8 has been strengthened from "reasonable measures" to "best endeavours". This change followed a respondent's view that the requirements on the transmission business for separation should be for it to use its best endeavours rather than reasonable measures and NGT's view that the arrangements between competitive/monopoly should be at least as strong as those required between network businesses.

4.614. Ofgem notes that the defined terms "metering business" and "meter-related services business" do differ as they refer to different versions of Transco's Network Code at different points in the past.

4.615. Furthermore, the provisions of paragraph 1 of Standard Special Condition A33 have been augmented for LNG Storage by paragraph 10 of NTS Special Condition C1.

4.616. Ofgem considers that these changes constitute only a partially satisfactory solution to the consent issue, and, without fettering its discretion, considers that further modifications in this respect may be required as part of the section 23 process planned for May 2005.

- 4.617. Ofgem therefore proposes that the requirements relating to the restriction on use of certain information and Independence of the Transportation Business, as currently set out in Standard Condition 39 should be replaced with Standard Special Condition A34 which would be applicable to all NTS and DN-GT licensees. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 39 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.618. Ofgem invites respondents' views on its proposals for Amended Standard Condition 39. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 40 – Appointment of Compliance Officer***

### **Description**

- 4.619. The licensee is obliged to ensure that at all times it employs a competent person (the compliance officer) for the purpose of facilitating compliance with Standard Condition 39. The licensee is also obliged to furnish to the Authority and publish in the form and manner directed by the Authority a report on the compliance officer's activities.

### **Next Steps document**

- 4.620. In the next steps document Ofgem proposed, similarly to Amended Standard Condition 39, to switch off this provision and introduce new provisions in a standard special condition in order to update the business separation regime to reflect arrangements that apply in electricity.

## **Respondents' views**

### *NGT*

- 4.621. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.622. One potential purchaser accepted the application and drafting of Standard Special Condition A34.
- 4.623. Another potential purchaser stated that the application of this condition needed to be considered separately in relation to each of the potential owners of the IDNs and the RDNs.

### *Shippers/suppliers*

- 4.624. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.625. The licence condition drafting for Standard Special Condition A34 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

## **Ofgem's proposals**

- 4.626. Ofgem continues to consider it appropriate to align the arrangements for business separation in gas with those in electricity as part of the DN sales process. Furthermore, a number of modifications have been made to the drafting of Standard Special Condition A34 to correct errors in the drafting published as part of the next steps document, for example by inserting the word "investigations" in paragraph 7(c)(i).

- 4.627. Ofgem therefore proposes that the requirements relating to compliance officers, as currently set out in Standard Condition 40 should be replaced with Standard Special Condition A34 which would be applicable to all NTS and DN-GT licensees. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 40 will then be switched off.
- 4.628. Ofgem invites respondents' views on its proposals for Standard Condition 40. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Condition 41 – Prohibition of Cross-Subsidies***

### **Description**

- 4.629. This condition requires the licensee to procure that its transportation business does not give or receive any cross subsidy to or from any other business of the licensee or of an affiliate or related undertaking of the licensee.

### **Next Steps document**

- 4.630. In the next steps document Ofgem noted that it had made clear that each DN would have a separate price control and that separate regulatory accounts would be required from each DN business. Ofgem stated that it was satisfied that these requirements along with the prohibition of cross-subsidies contained in this provision should be sufficient to protect the interests of customers.
- 4.631. Ofgem detailed that following consideration of respondents' views, it proposed that Standard Condition 41 should be switched off and replaced with a standard special condition which would include an additional provision. Ofgem detailed that this additional provision would clarify that, in the event that the licensee's transportation business contains more than one transmission and/or distribution

business, the prohibition on cross subsidies would apply in respect of each individual transmission and/or distribution business.

- 4.632. Ofgem stated that it intended to present an initial draft of these proposed licence conditions to the DISG and to invite comments on the drafting.

### **Respondents' views**

#### *NGT*

- 4.633. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.634. One potential purchaser accepted the application of Standard Special Condition A35 and the associated switching off of condition Standard Condition 41. Another potential purchaser considered that a definition of “transportation business” was required and that this definition should relate to the transportation business of each separate DN where a licensee owns more than one. Another potential purchaser considered that it was unclear from this condition whether each DN owned by Transco is regarded as a separate business or not.

#### *Shippers/suppliers*

- 4.635. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.636. The licence condition drafting for Standard Special Condition A35 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.637. Following consideration of respondents' views, Ofgem has produced drafting that adds to that of Standard Condition 41, by clarifying the prohibition of cross-subsidies, in the case of Transco, between the NTS business and the RDN business and also between individual distribution networks within the RDN business. This proposed drafting is consistent with the definitions of NTS operator and DN operator introduced into Standard Special Condition A3.
- 4.638. For the avoidance of doubt, Ofgem would note that the provisions of paragraph 1 of this condition also prohibit cross-subsidies between competitive and monopoly businesses.
- 4.639. Ofgem therefore proposes that the provisions of Standard Condition 41 be placed, subject to the modifications above, in Standard Special Condition A35 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 41 will then be switched off.
- 4.640. Ofgem invites respondents' views on its proposals for Standard Condition 41. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 45 – Undertaking from an Ultimate Controller***

### **Description**

- 4.641. Amended Standard Condition 45 sets out the requirement on the licensee to obtain a legally enforceable undertaking from each and every person who is an ultimate controller of the licensee in the form specified by the Authority, that the ultimate controller will:
- ◆ refrain from any action; and
  - ◆ procure that any person whom it controls will refrain from any action,

which would then be likely to cause the licensee to be in breach of any of its obligations under the Gas Act or licence.

- 4.642. Transco's existing licence condition is an amended standard condition. Previous amendments to this condition have incorporated an alternative definition of ultimate controller to that set out in the standard condition. The definition has subsequently reverted to the standard definition and, as such, this condition is now in the standard form.

### **Next Steps document**

- 4.643. In the next steps document Ofgem proposed to adopt the standard form of Amended Standard Condition 45 in all NTS and DN-GT licences.

### **Respondents' views**

#### *NGT*

- 4.644. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.645. One potential purchaser accepted the application and the drafting of Amended Standard Condition 45.
- 4.646. Another potential purchaser fully supported the need for an undertaking to ensure a level playing field between the RDNs and the IDNs. However this potential purchaser suggested that the undertaking be in favour of the Authority to allow the Authority to involve the ultimate controller in amending any inappropriate behaviour of the licensee should the licensee fail to respond to any requests from the Authority.

#### *Shippers/suppliers*

- 4.647. No shipper/supplier provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.648. This condition was discussed at DISG 29. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during this meeting and by written responses after this meeting.

### **Ofgem's proposals**

- 4.649. Ofgem continues to propose to adopt the standard form of Amended Standard Condition 45 in all NTS and DN-GT licences. The drafting for this condition is provided for comment in Appendix 7.
- 4.650. However, Ofgem is minded to consider bringing this condition into line with the equivalent condition in the electricity DNO licences as part of the section 23 process immediately following hive-down in May 2005. This proposal would improve the requirements of the condition with respect to the recognition of a company or person as being the ultimate controller. As such, Standard Condition 45 would be switched off in the licences of NTS and DN-GTs and a new standard special condition would be created. The proposed drafting in this regard will be brought to a future DISG for comment.
- 4.651. Ofgem invites respondents' views on its proposals for Amended Standard Condition 45. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Amended Standard Condition 47– Indebtedness***

### **Description**

- 4.652. This condition prevents the licensee from incurring inappropriate indebtedness or giving any form of security or guarantee unless it is on an arm's length basis, on normal commercial terms and for some of the permitted purposes and, where relevant, in accordance with Amended Standard Condition 29 (disposal of



assets). Otherwise, new (i.e. all but “pre-relevant date”<sup>38</sup>) indebtedness, without the prior written consent of the Authority is prohibited.

- 4.653. The condition requires the prior written consent of the Authority for transfers, leases etc, of any asset, right, sum or benefit etc. to any affiliate or related undertaking subject to certain exceptions.

### **Next Steps document**

- 4.654. In the next steps document Ofgem stated that it would be appropriate to revert to the standard form of Standard Condition 47 in all NTS and DN-GT licences and the associated standard cross-default obligation provisions. However, Ofgem detailed that there would be a need to modify the condition to allow for changes to conform NTS and DN-GT licences to the standard form of this condition proposed for electricity distribution licence as part of the DPCR 4 process. Ofgem set out that, in particular, changes would be made to include the cash lock up.
- 4.655. Ofgem stated that the cash lock up provisions require that, with certain limited exceptions, the licensee shall not, without the prior written consent of the Authority, transfer, lease, licence or lend any sums, assets, rights or benefit as allowed under paragraph 1. If the licensee ceases to hold an investment grade credit rating or if the licensee’s lower or lowest rating is at the minimum investment grade level (BBB-/Baa3) and is placed under review for possible downgrade or on credit watch with negative implications, or its rating outlook is changed to negative from positive or stable. Ofgem set out that where this was the case and, until such time as all the licensee’s ratings are restored to a level above the trigger, the licensee shall not transfer, lease, licence or lend any sums, assets, right or benefit, without prior written consent of the Authority following disclosure of all material facts, other than for certain exceptions.
- 4.656. Ofgem stated that the provisions contained in the designated standard condition with the necessary amendments would be placed in a standard special condition applicable to all NTS and DN-GTs. In addition, Ofgem will replace the explicit provision relating to pre relevant date cross defaults within the licence, where

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<sup>38</sup> The relevant date is defined in Transco’s licence as 13 December 1999, which is the date under which

appropriate with a consent, on condition that Transco will continue to use its reasonable endeavours to eliminate its cross default obligations.

### **Respondents' views**

#### *NGT*

4.657. NGT stated that currently the de minimis caps are set on aggregate Transco 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), NGT suggested that it would be 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. NGT stated that if a financial limit on de minimis "extensions" were to be set, it considered 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, NGT stated that there was currently no meaningful investment denominator since share capital, premia and consolidated reserves exist at Transco level rather than GT business level.

#### *Potential Purchasers*

4.658. One potential purchaser accepted the application and the drafting of Standard Special Condition A39 and the assumed associated reversion of Amended Standard Condition 47 to a standard condition that would then be switched off. This respondent also accepted the inclusion of relevant drafting from what was Special Condition 5 and the removal of that special condition in consequence. This respondent also noted that further changes may arise as a result of the DCPR 4 consultation process.

### *Shippers/suppliers*

- 4.659. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.660. The licence condition drafting for Standard Special Condition A39 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 34 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.661. NGT expressed their concern that the cash lock up clause still did not seem to cater for circumstances where all but one of the rating agencies rates the credit as “investment” grade. NGT suggested that an additional clause (b) could be inserted “the licensee’s issuer credit rating by any of Standard & Poor’s Ratings Group, Fitch Ratings Ltd and Moody’s Investor Service Inc falls below the rating specified by any of these credit rating agencies from time to time as its lowest investment grade credit rating”.
- 4.662. One potential purchaser stated that it was comfortable with the revised drafting of this licence condition

### **Ofgem’s proposals**

- 4.663. Following consideration of respondents’ views, as expressed within formal responses to the next steps document, comments from DISG members, and comments received by Ofgem in relation to the DPCR 4 consultation, Ofgem has incorporated the drafting of the equivalent condition proposed for the electricity distribution companies, with additional modifications as necessary to reflect the businesses within the gas industry and the fact that Transco will hold two licences within the same legal entity.
- 4.664. Following consideration of respondents’ views, the majority of the amendments that have been made have been in line with the changes proposed for the electricity licence as a result of the DPCR 4 consultation. These include changes

to paragraphs 3 and 4 and the insertion of definitions for “investment grade” and “issuer credit rating”.

- 4.665. In addition to the standard drafting for this condition, an additional paragraph (paragraph 6) has been added to clarify that, for the purposes of this condition, references to “licensee” shall mean the legal entity that holds the licence concerned, i.e. Transco rather than Transco’s NTS or RDN businesses. This is necessary because this condition relates financial issues that are relevant at the legal entity level.
- 4.666. Ofgem therefore proposes that the provisions of Amended Standard Condition 47 be replaced by Standard Special Condition A39 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Amended Standard Condition 47 will revert to a designated standard condition within all NTS and DN-GT licences, which will then be switched off.
- 4.667. Ofgem invites respondents’ views on its proposals for Amended Standard Condition 47. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.
- 4.668. Ofgem would note that, to the extent to which any inconsistencies remain between the DNO and GT licences with respect to this condition, these may be corrected as part of a further section 23 process subsequent to hive-down in May 2005.

## ***Standard Condition 48 – Last Resort Supply: Payment Claims***

### **Description**

- 4.669. Standard Condition 48 sets out the circumstances under which the licensee is required to increase its transportation charges in order to compensate any gas

supplier which claims for losses that it has incurred in complying with a last resort supply direction. Where the licensee receives from a claimant supplier a valid claim for a last resort supply payment, it is required to make a consequential increase in its transportation charges to such an extent as it reasonably estimates to be appropriate to secure that such consequential increase in its revenue equals the specified amount of the claim by the supplier.

### **Next Steps document**

- 4.670. In the next steps document Ofgem considered that it would be appropriate for this condition to apply to all GT licences including NTS and DN-GT licence holders. Ofgem recognised that if it were necessary for the provisions of this clause to be enacted the relevant GT may also need to change its transportation charges on a date other than those specified in Standard Special Condition A4. Ofgem considered that such situations could fall outside of the reasonable endeavours obligation and that such additional changes may be unavoidable in order to ensure that suppliers are protected in respect of a last resort order.
- 4.671. Ofgem therefore proposed to adopt the standard form of Standard Condition 48 in all GT licences including NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 4.672. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.673. One potential purchaser accepted the application and the drafting of Standard Condition 48.

#### *Shippers/suppliers*

- 4.674. One shipper/supplier suggested that whilst NGT was the major GT operating, this condition was broadly workable but to include this as a standard condition, applicable to all GTs, implies that in future, any Supplier of Last Resort (SoLR) payment claims would need to be made at a network level. This shipper/supplier

considered that this would be inefficient, and that such claims would be more effectively made and processed through a single, co-ordinating entity. This shipper/supplier preferred that this condition be amended to facilitate co-operation and a further condition placed on NGT to co-ordinate SoLR claims.

#### *DISG comments*

4.675. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

#### **Ofgem's proposals**

4.676. Following consideration of these issues further and taking into consideration respondents' views, Ofgem has altered its proposals for Standard Condition 48. The drafting of Standard Condition 48 includes a cross-reference to Amended Standard Condition 4, which is proposed to become Standard Special Condition A4. As such, Ofgem decided that it would be appropriate to switch this condition off and introduce a standard special condition with the equivalent provisions and updated cross-references.

4.677. Furthermore, following consideration of respondents' views, Ofgem has made some additional modifications to the drafting of this condition, including, but not limited to:

- ◆ the insertion of an additional paragraph at paragraph 16 that states that the arrangements for administering transportation charges in order to compensate any gas supplier which claims for losses that it has incurred in complying with a last resort supply direction, shall be administered by the agency, unless the Authority otherwise consents in writing; and
- ◆ a minor modification to paragraph 8 such that transportation arrangements are not restricted to arrangements with gas shippers given the DTI's proposals to grant an exemption to relevant gas transporters.

- 4.678. Ofgem therefore proposes that the provisions of Standard Condition 48 be placed, subject to the modifications above, in Standard Special Condition A48 applicable to all NTS and DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8A. Standard Condition 48 will then be switched off.
- 4.679. Ofgem invites respondents' views on its proposals for Standard Condition 48. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Conditions***

### ***Special Condition 1 – Interpretation and Construction***

#### **Description**

- 4.680. Special Condition 1 sets out some of the rules for the interpretation and construction of the special conditions. Unless the context requires otherwise, words and expressions used in the standard conditions of the licence have the same meaning as in the special conditions. It should be noted that some of the special conditions also set out particular definitions or interpretations which are specific to the condition in question.

#### **Next Steps document**

- 4.681. In the next steps document Ofgem stated that due to the proposed changes to a number of the special conditions currently within Transco's licences, some of the definitions within Special Condition 1 were no longer required, and as such Ofgem proposed to delete these provisions.
- 4.682. Ofgem outlined that the provisions contained in Amended Standard Condition 1, which provides definitions across NTS and DN-GTs, would become part of a new standard special condition (Standard Special Condition A3), supplemented by additional definitions as required. However, Ofgem detailed that it remained

of the view that it could be necessary to include further definitions within special conditions applicable to individual licensees.

- 4.683. Ofgem clarified that the definitions that would be included in these new licence conditions would need to follow the restructuring of the licence and the commercial regime as a whole. As such, Ofgem detailed that new definitions may need to be discussed through the DISG.

### **Respondents' views**

#### *NGT*

- 4.684. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.685. One potential purchaser noted that the provisions of any replacement of Special Condition 1, over and above those in Standard Special Condition A3, discussed above, will be subject to later drafting to be considered in DISG.

#### *Shippers/suppliers*

- 4.686. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### **Ofgem's proposals**

- 4.687. Ofgem continues to propose the deletion of this special condition on the grounds that it is no longer required. The provisions contained in Amended Standard Condition 1, which provides definitions across NTS and DN-GTs, have become part of a new standard special condition (Standard Special Condition A3), which has been supplemented by additional definitions as required. The approach which Ofgem has adopted for definitions was discussed earlier in this chapter.
- 4.688. Ofgem invites respondents' views on its proposals for Special Condition 1. The drafting for this condition is provided for comment in Appendix 7. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned



for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 2 – Restriction on Activity and Financial Ring-Fencing***

### **Description**

4.689. This condition prohibits the licensee from undertaking any business other than:

- ◆ the Transco Business<sup>39</sup>;
- ◆ a business for which the Authority has given express consent; or
- ◆ a “de minimis” business.

4.690. The condition states that the licensee shall not, without the written consent of the Authority, hold or acquire shares or other investments of any kind except in prescribed circumstances.

4.691. The condition also imposes a reasonable endeavours obligation on the licensee to cease to conduct and carry on a business or activity which it was conducting or carrying on at the relevant date and which it would otherwise be prohibited by this condition from conducting. The licensee is required to submit a report to the Authority setting out its endeavours to comply with this condition.

### **Next Steps document**

4.692. In the next steps document Ofgem stated that it remained of the view that the provisions of Standard Condition 43, which is currently switched off in Transco's licences, should replace the wording of this condition. However, Ofgem clarified that, rather than applying Standard Condition 43 as currently drafted, a

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<sup>39</sup> Including Transportation and LNG storage, the Metering Business and the Meter Reading Business. The Condition provides that LNG Storage may be excluded from the scope of the condition if the Authority so directs.

standard special condition would be introduced containing the provisions contained in this condition, with necessary amendments which would:

- ◆ retain the definition of “investment” previously applied in Special Condition 2 such that account would continue to be taken of income received by the licensee in respect of such investment; and
- ◆ replace “transportation business” with a reference to the definition of “permitted purpose” in what is currently Amended Standard Condition 32.

4.693. Ofgem outlined that these provisions would be set out in a standard special condition applicable to all NTS and DN-GTs. Ofgem stated that the provisions contained in the designated standard condition with the necessary amendments would be placed in a standard special condition applicable to all NTS and DN-GTs. In addition, Ofgem will replace the explicit provision relating to pre relevant date cross defaults within the licence, where appropriate with a consent, on condition that Transco will continue to use its reasonable endeavours to eliminate its cross default obligations.

4.694. Ofgem stated that it was of the view that SOMSAs should not be regulated but clarified that it would be necessary to amend Standard Special Condition A36 (Restriction on Activity and Financial Ring Fencing) to accommodate income from new service agreements such as SOMSAs. As such, as part of the next steps document Ofgem drafted a new RDN special condition (Special Condition E1) to adjust the de minimis percentage restriction for a specified period such that in aggregate, de minimis turnover and investments would not exceed a specified amount for that period.

### **Respondents' views**

*NGT*

4.695. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.696. One potential purchaser accepted the application and drafting of Standard Special Condition A36 and the removal of Special Condition 2.
- 4.697. Another respondent noted that Ofgem intends to revisit this condition to ensure that there is appropriate separation between NTS and RDN activities. This purchaser questioned how newly created licensees will fulfil the requirement for most recent audited accounting statements, as they will not have such accounts.
- 4.698. One potential purchaser suggested that it is inconsistent to include reference to storage assets in definitions of transportation arrangements.

#### *Shippers/suppliers*

- 4.699. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.700. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.701. In relation to the drafting of Standard Special Condition A36, NGT stated their view that paragraph 2(b) of this condition only permitted the licensee to acquire shares or other investments in a body corporate (which is a subsidiary of the licensee and incorporated by it solely for the purpose of raising finance for the transportation business), therefore, it is much narrower in scope and, in order to reproduce the effect of the existing condition, needs to be expanded to cover investments in a company incorporated for raising finance for any other transportation business operated by the licensee, the metering business, the meter reading business, and any other business covered by paragraph 4 of the condition. To do otherwise, would limit Transco's ability to raise finance, and force it to have separate finance-raising companies for each of the NTS and DN businesses. Transco noted that, alternatively, paragraph 2(b) could be drafted to

permit investment in a company incorporated to raise finance for “any item falling within the definition of permitted purpose contained in Standard Special Condition A32 (Definition of Permitted Purpose) of this licence and any other licence held by the licensee in the same legal entity”

- 4.702. Transco currently has a de minimis cap across all of its transportation businesses. The Ofgem proposal will mean that the NTS and DN-GTs will have individual caps. NGT stated the view that in paragraph 4(b)(i), the drafting introduces erosion of the de minimis cap by defining the 2.5% limit as all the licensee’s de minimis revenue, divided by the licensee’s transportation revenue turnover, as per the regulatory accounts.
- 4.703. NGT further stated that some of the paragraphs make reference to the equity share of the relevant associate (4(d)(ii)), but the others do not, instead referring to the absolute amount. If a GT only owns 10% of a company, it should not include 100% of its costs, revenue etc in the calculation of “investment”. Therefore they expressed the view that paragraph 4(d)(iii) and the income reference immediately below should refer to the equity share of relevant associates commitments, liabilities and income.
- 4.704. Furthermore, following discussions with NGT and at DISG it has become clear that there will be a number of service agreements between the NTS, the RDN business, and the IDNs that would require extensions to the de minimis caps of each licensee for varying lengths of time.
- 4.705. One potential purchaser stated that they were unsure whether the issue associated with de minimis limits and the new service agreements that were being set up as part of the DN sales process had been resolved. They therefore stated that they might like to comment further on this licence condition. Furthermore, they were also unsure whether the IDNs would have audited accounting statements against which de minimis business limitations could be measured. To the extent that these two issues had not been addressed, they believed that the drafting of this condition might need to change.

### **Ofgem’s proposals**

- 4.706. Ofgem proposes to bring the drafting of this condition into line with that proposed for electricity DNO licences as part of the DPCR 4 consultation.

- 4.707. Following consideration of respondents' views, as expressed within formal responses to the next steps document, comments from DISG members, and comments received by Ofgem in relation to the DPCR 4 consultation, Ofgem has incorporated the drafting of the equivalent condition proposed for the electricity distribution companies, with additional modifications as necessary to reflect the businesses within the gas industry.
- 4.708. In the section of the condition which sets out the limitation on the licensee or relevant associates carrying out de minimis business there is a change to the calculation of turnover and investment to more properly reflect the contribution of the relevant associates. This is to revise the calculation so it is in accordance with the purpose of the condition.
- 4.709. In finalising the common elements to this condition, a number of modifications have been made to the draft consulted upon as part of the DPCR 4 consultation.
- 4.710. However, as stated above, it has been necessary to make a number of additional modifications to the standard drafting to reflect gas industry specific factors, which include, but are not limited to:
- ◆ in paragraphs 1, 2(b) and 4(a), reference to the definition of "permitted purpose" in Standard Special Condition A32;
  - ◆ modification of paragraph 4(b)(i) such that Transco's transportation, metering, meter reading (and where appropriate the LNG Storage business) are referenced;
  - ◆ modification of paragraph 2(b) to recognise "of this licence and any other licence held by the licensee in the same legal entity;
  - ◆ specification of the date in paragraph 4(d)(i) at which the condition became effective in Transco's licence; and
  - ◆ the insertion of a paragraph (paragraph 6) that reflects the fact that, in the case of Transco, references to "licensee" shall mean Transco plc rather than the NTS business or the RDN business individually.
- 4.711. The provisions in paragraph 4(b)(i) of this condition are augmented by paragraph 11 of NTS Special Condition C1 to include provisions relating to LNG Storage.

- 4.712. In the next steps document, Ofgem proposed to augment this condition with RDN Special Condition E1 such that the de minimis cap was extended to reflect the additional de minimis activities undertaken by the RDN business. However, as discussed in Chapter 3, and Chapter 5, following consideration of the treatment of de minimis businesses, Ofgem proposes to grant time-limited consent these activities under the provisions of paragraph 3(d) such that these activities are not included in the definition of de minimis business in paragraph 4(a). As such, Ofgem no longer proposes to augment the cap on de minimis businesses through special conditions, and as such the provisions of the RDN Special Condition E1, as originally drafted, have been deleted. The revised drafting for the newly created Standard Special Condition A36 is provided for comment in Appendix 8A.
- 4.713. Ofgem invites respondents' views on its proposals for Special Condition 2. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.
- 4.714. Ofgem would note that, to the extent to which any inconsistencies remain between the DNO and GT licences with respect to this condition, these may be corrected as part of a further section 23 process subsequent to hive-down in May 2005.

### ***Special Condition 3 – Availability of Resources***

#### **Description**

- 4.715. This condition states that the licensee shall ensure that it has sufficient resources to carry out its transportation and LNG storage business properly and efficiently and to comply with all of its relevant obligations. The licensee is also obliged to submit to the Authority, each year, a Board approved certificate relating to the adequacy of its resources to carry on the activities authorised by the licence.

4.716. This condition also includes a requirement for a specific certificate before any dividend or distribution may be paid or made and prohibits such dividends or distributions if the requisite certificate is not provided. As part of the DPCR 4 licence consultation it is proposed to amend this provision to extend its requirements so that it is clear that it also applies to the repurchase of shares.

### **Next Steps document**

4.717. In the next steps document Ofgem stated that LNG Storage provisions should be contained in a special condition applicable to the NTS, and that it considered that Special Condition 3 should continue to apply as a standard special condition applicable to NTS and DN-GTs (excluding LNG Storage references).

4.718. To address the issue of LNG Storage, Ofgem further proposed that:

- ◆ this standard special condition should revert to the references to storage facilities contained in the standard conditions designated by the Secretary of State under the Utilities Act; and
- ◆ a new NTS Special Condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 12).

### **Respondents' views**

#### *NGT*

4.719. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

4.720. One potential purchaser accepted the application and the drafting of Standard Special Condition A37.

#### *Shippers/suppliers*

4.721. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

*DISG comments*

- 4.722. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.723. At DISG 34, Ofgem presented revised drafting for Standard Special Condition A37, consistent with the proposals for the equivalent condition within electricity distribution conditions at that time. At this meeting, Ofgem stated that it was the intention to bring the provisions in Transco's GT licence into line with other network licences. The changes made to bring this condition in line with the electricity equivalent include;
- ◆ a change to the submission date to align it with the date the regulatory accounts will be provided to the Authority;
  - ◆ a change so that the report that must be provided by the auditors with reference to the annual certificate will refer to its regulatory accounts audit work;
  - ◆ a change so that the requirement to obtain an auditors report from "best endeavours" to "to must"; and
  - ◆ extra supporting information to be provided with the annual certificate that is required by this condition.
- 4.724. In response, NGT stated that paragraph 3 added two new requirements to the resources certificate that are significantly more onerous (and less clear - especially in relation to the definition of "financial facilities") than at present. Since this would involve NGT incurring additional expenditure, while providing no additional assurances to Ofgem, they requested reversion to the original wording.
- 4.725. NGT stated that the change from "best endeavours" obligation, " to "must" in relation to obtaining an auditors report and could be problematic. NGT stated that they believe that certificate ought to be sufficient. In addition, NGT stated



that the new requirement would effectively duplicate the requirement which may have the effect of increased cost for the licensee. Secondly, NGT also pointed out that the revised DPCR 4 drafting would require sign-off by the regulatory accounts auditors rather than the statutory accounts auditors, which could lead to timing problems if the regulatory accounts audit is delayed until 31 July.

### **Ofgem's proposals**

- 4.726. Following consideration of respondents' views, Ofgem continues to consider that the provisions of this condition should be modified to achieve consistency between network licences, and, as such, will be making changes to this condition in accordance with the DPCR 4 amendments.
- 4.727. The provisions in paragraph 1(a) and paragraph 8 of this condition are augmented by paragraph 12 of NTS Special Condition C1 to include provisions relating to LNG Storage.
- 4.728. Ofgem proposes that the provisions of Special Condition 3 be replaced by Standard Special Condition A37 applicable to all NTS and DN-GTs. The revised drafting for these conditions is provided for comment in Appendix 8A.
- 4.729. Ofgem invites respondents' views on its proposals for Special Condition 3. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.
- 4.730. Ofgem would note that, to the extent to which any inconsistencies remain between the DNO and GT licences with respect to this condition, these may be corrected as part of a further section 23 process subsequent to hive-down in May 2005.

## ***Special Condition 4 – Investment Grade Credit Rating as Issuer of Corporate Debt***

### **Description**

- 4.731. This condition obliges the licensee to use all reasonable endeavours to maintain an investment grade credit rating and is based upon Standard Condition 46, which is currently switched off in Transco's licences.

### **Next Steps document**

- 4.732. Ofgem proposed the introduction of a standard special condition, based on designated Standard Condition 47, and the modification of this to include Fitch rating agency as well as Standard & Poor's and Moody's. In the next steps document Ofgem agreed with views expressed by respondents that the inclusion of Fitch or other rating agencies as well as Standard & Poor's and Moody's was not directly related to the DN sales process. However, Ofgem considered that, as part of the DN sales licence review process, it would introduce minor adjustments to ensure the promotion of consistent Ofgem policy across the electricity and gas sectors where appropriate.

### **Respondents' views**

#### *NGT*

- 4.733. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.734. One potential purchaser accepted the application and the drafting of Standard Special Condition A38.
- 4.735. Another potential purchaser suggested that the drafting assumes that a new licensee has an investment grade issuer credit rating in place whereas the obligation should be a reasonable endeavours one.

### *Shippers/suppliers*

- 4.736. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.737. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 34 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.738. Following consideration of respondents' views, as expressed within formal responses to the next steps document, comments from DISG members, and comments received by Ofgem in relation to the DPCR 4 consultation, Ofgem has incorporated the drafting of the equivalent condition proposed for the electricity distribution companies, with additional modifications as necessary to reflect the differences in the gas industry.
- 4.739. The main changes to this condition continue to be the introduction of the Fitch rating agency as well as Standard & Poor's and Moody's.
- 4.740. Following consideration of respondents' views, the majority of the amendments that have been made have been in line with the changes proposed for the electricity licence as a result of the DPCR 4 consultation. These include changes to paragraph 2 such that the terms "investment grade" and "issuer credit rating" are defined.
- 4.741. In addition to the standard drafting for this condition, an additional paragraph (paragraph 3) has been added to clarify that, for the purposes of this condition, references to "licensee" shall mean the legal entity that holds the licence concerned, i.e. Transco rather than Transco's NTS or RDN businesses. This is necessary because this condition relates to financial issues that are relevant at the statutory entity level.

- 4.742. Furthermore, as discussed in Chapter 5, this condition is augmented by Special Condition E11 within the licences of the DNs that Transco is planning to sell. Special Condition E11 augments paragraph 1 of Standard Special Condition A38 within the licences of each of the hived-down DN for the period between hive-down and share sale. The provisions in Special Condition E11 mean that the Authority is able to give prior permission to any such arrangements that the Authority considers appropriate. The Authority proposes to issue “keep well” agreements to Transco in this regard. Furthermore, this provision will include a sunset clause meaning it will cease to apply following share sale.
- 4.743. Ofgem therefore proposes that the provisions of Special Condition 4 be replaced by Standard Special Condition A38 applicable to all NTS and DN-GTs which contains the modifications described above. The revised drafting for this condition is provided for comment in Appendix 8A.
- 4.744. Ofgem invites respondents’ views on its proposals for Special Condition 4. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.
- 4.745. Ofgem would note that, to the extent to which any inconsistencies remain between the DNO and GT licences with respect to this condition, these may be corrected as part of a further section 23 process subsequent to hive-down in May 2005.

## ***Special Condition 5 – Cross-Default Obligations***

### **Description**

- 4.746. This condition prohibits the licensee from entering into or continuing with any cross-default obligations without the prior consent of the Authority.

## **Next Steps document**

- 4.747. In the next steps document Ofgem stated that it was of the opinion that this Special Condition should be removed as part of the licence modifications necessary as part of the DN sales process. Ofgem clarified that a standard special condition had been introduced (Standard Special Condition A39), which reflected the wording of Designated Standard Condition 47 with some necessary amendments and that, as such, Special Condition 5 (and its associated provisions) had been removed from the draft licence.
- 4.748. Ofgem outlined that consents granted to Transco in relation to pre relevant date indebtedness would be preserved to the extent that such obligations would remain outstanding.

## **Respondents' views**

### *NGT*

- 4.749. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.750. One potential purchaser accepted the proposed removal of this condition.

### *Shippers/suppliers*

- 4.751. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.752. No comments were made at DISG in relation to this issue.

## **Ofgem's proposals**

- 4.753. Ofgem continues to believe that it is appropriate to remove the provisions in Special Condition 5 as these issues are now dealt with in the proposed Indebtedness condition (Standard Special Condition A39). The revised drafting for this condition is provided for comment in Appendix 8A. Ofgem will replace

the explicit provision relating to pre relevant date cross defaults obligations within the licence, where appropriate with a consent, on condition that Transco will continue to use its reasonable endeavours to eliminate its cross default obligations.

- 4.754. Ofgem invites respondents' views on its proposals for Special Condition 5. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 9D – Restriction of Prices for LNG Storage Services***

### **Description**

- 4.755. This condition sets out the charges which the licensee may apply for the supply of LNG Storage services at certain sites on the NTS network. The licensee may not deviate from those charges except with the Authority's prior written consent.

### **Next Steps document**

- 4.756. In the next steps document Ofgem stated that it would be minded to include current licence obligations relating to LNG Storage, within Transco's NTS-GT licence only. As such, Ofgem was of the opinion that this special condition should be a special condition applicable to Transco's NTS only.

### **Respondents' views**

*NGT*

- 4.757. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.758. One potential purchaser accepted that these provisions should be a special condition in the NTS only part of the licence.

#### *Shippers/suppliers*

- 4.759. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.760. This condition was discussed at DISG 29 and DISG 34. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings.

### **Ofgem's proposals**

- 4.761. As discussed earlier, Ofgem intends to include current licence obligations relating to LNG Storage, within Transco's NTS-GT licence only. As such, Ofgem intends to introduce the requirements of this condition as a Special Condition C3 applicable to Transco's NTS only.
- 4.762. Ofgem notes that it is the current expectation that it will be possible to remove the Isle of Grain entry in Table 1 in the near future<sup>40</sup>. However, as no firm date is available for this decommissioning to a LNG import facility, this condition may be further modified as a result of a further section 23 licence modification process subsequent to hive-down.
- 4.763. The drafting for this condition is provided for comment in Appendix 8C. Ofgem invites respondents' views on its proposals for Special Condition 9D. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the

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<sup>40</sup> The LNG Storage facility at the Isle of Grain, presently operated as a storage facility by Transco under a lease back arrangement from Grain LNG Ltd, is due to end when the facility starts commissioning as a

conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 17 – Operational Guidelines for Balancing***

### **Description**

- 4.764. This condition requires the establishment of operational guidelines consistent with the Network Code, specifying the particular balancing measures that the licensee expects to take. This condition also provides for the publication and modification of the guidelines and the preparation of reports to the Authority.

### **Next Steps document**

- 4.765. In the next steps document Ofgem stated that it considered that this condition should be deleted and superseded by the provisions of existing Special Condition 27.

### **Respondents' views**

#### *NGT*

- 4.766. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.767. One potential purchaser agreed that this condition be removed and the relevant provisions of present Special Condition 27 used instead.

#### *Shippers/suppliers*

- 4.768. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.



### *DISG comments*

4.769. No comments were made at DISG in relation to this issue.

### **Ofgem's proposals**

4.770. Ofgem continues to believe that this condition should be deleted and replaced by the provisions of Special Condition C5, applicable to the NTS licensee. The drafting of Special Condition C5 is provided for comment in Appendix 8C.

4.771. Ofgem invites respondents' views on its proposals for Special Condition 17. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 18 – Conveyance to Independent Systems***

### **Description**

4.772. Under the provisions of Special Condition 18, customers connected to independent networks should be charged an average price for conveyance of gas which is "no more than the average charge for conveyance to premises in Great Britain". In the case of the Liquid Petroleum Gas (LPG) networks, Ofgem outlined that Transco was required to subsidise the cost of the gas itself, as well as the costs of conveyance.

### **Next Steps document**

4.773. In the next steps document it was detailed that Ofgem had asked the Department of Trade and Industry (DTI) to review Special Condition 18 in Transco current GT licence. Ofgem stated that during the implementation of the Gas Act 1995, the DTI took the view that customers connected to independent systems that were supplied with Liquid Natural Gas (LNG) and LPG should not be denied the advantages of competition. Ofgem set out that, as a result, Special Condition 18

was a condition that was included in Transco GT licence, on 1 March 1996, at the DTI's behest.

- 4.774. In the next steps document Ofgem outlined that there were five independent LNG networks in Scotland and four independent LPG networks (in Scotland, Wales and the North of England). Ofgem stated that all of these networks were independent networks when Special Condition 18 was introduced (i.e. separate from the main UK gas transportation system), and that all of these systems, bar one, remain independent.
- 4.775. Ofgem highlighted that the DTI would be issuing a position paper in due course to inform the industry of the way in which it proposes to take this matter forward. Ofgem explained that the DTI wished to notify all relevant parties that the review would be taking place and that it would welcome comments from respondents on this issue. In this regard Ofgem set out that following the outcome of the DTI's review of the provisions of Special Condition 18, any changes necessary to Transco's licences would be implemented as part of the formal section 8AA consultation.

### **Respondents' views**

#### *NGT*

- 4.776. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.777. One potential purchaser noted that this condition is subject to a DTI position paper to be issued in due course.

#### *Shippers/Suppliers*

- 4.778. One shipper/supplier was concerned to note that there did not currently appear to be a replacement licence condition in respect of Special Condition 18. Whilst they appreciated that the DTI is considering the issues raised by this areas, they believed that the existing text should be included as an interim measure prior to the drafting of revised text.

4.779. No comments were made at DISG in relation to this issue.

### **Ofgem's proposals**

4.780. As discussed in Chapter 3, the DTI published a position paper, in January 2005, outlining the proposed treatment of independent systems (this position paper is provided in Appendix 9). . Furthermore, the DTI published its proposed alternative arrangements within annexes of its "Statement of Reasons" document which was published on 14 February 2005.<sup>41</sup> Under these proposals, alternative arrangements determined as suitable by the Secretary of State will be put in place and, as such, Special Condition 18 is no longer required.

4.781. Ofgem is proposing a number of amendments to reflect the DTI's proposals in this area. These changes include:

- ◆ the deletion of Special Condition 18, on the understanding that the "alternative arrangements" determined by the DTI will sit outside of the licence;
- ◆ changes to the "disposal of assets" licence condition (As outlined earlier in this chapter) such that:
  - ◆ references to Special Condition 18 are removed;
  - ◆ consent to the disposal of these particular assets will only be required with respect to independent systems that remain independent; and
  - ◆ to ensure that there is enforceability of alternative arrangements; and
- ◆ minor changes to the "obligations as regard charging methodology" condition (As outlined earlier in this chapter) such that charging

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<sup>41</sup> [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

methodologies are required to reflect any alternative arrangements put in place in accordance with a determination by the Secretary of State.

- 4.782. Ofgem invites respondents' views on its proposals for Special Condition 18.

Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition 19 – Emergency Services to or on Behalf of Another Gas Transporter***

#### **Description**

- 4.783. This condition provides that the Authority can direct, following consultation with the HSE, for the licensee to offer terms to enter into an agreement with other gas transporters for the provision of emergency services where a major loss of supply has occurred. Such agreement may provide for the licensee to recover all costs reasonably related to the emergency service provision, a reasonable commercial profit and appropriate indemnities against third party claims.

#### **Next Steps document**

- 4.784. In the next steps document Ofgem set out its proposal to replicate the provisions of Special Condition 19 as a standard special condition applicable to all NTS and DN-GTs. In the next steps document Ofgem provided acknowledgment of the strength of responses to the more general emergency services related issues raised. Ofgem did not however believe that this condition should be expanded to cover emergency services between gas transporters other than when a major loss of supply occurs.
- 4.785. Ofgem noted concerns expressed by respondents regarding the definition of a "major loss of supply" but did not consider that such issues were within the scope of the DN sales process.

- 4.786. To address the issue of LNG, Ofgem further proposed that a new NTS Special Condition should be introduced to augment this standard special condition with LNG related provisions (Special Condition C1, paragraph 13).

### **Respondents' views**

#### *NGT*

- 4.787. The key points raised by NGT with respect to the provision of emergency services, are discussed in Chapter 3.

#### *Potential Purchasers*

- 4.788. The key points raised by potential purchasers with respect to the provision of emergency services, are discussed in Chapter 3.
- 4.789. One potential purchaser stated that it was appropriate to continue for the moment with the present arrangements regarding first response emergency services to IGTs and for this matter to be reviewed prior to contract expiry. Another potential purchaser accepted the application and the drafting of Standard Special Condition A41. This potential purchaser suggested that it might be unhelpful to attempt to define precisely the term "major loss of supply" as the lack of any such definition could possibly hinder a swift response to an incident.
- 4.790. One potential purchaser accepted the principle of this condition but suggested that it should be made clear that the requirement only applies to transporters connected downstream of the DN offtake points and not all transporters within the DN boundary. This purchaser also considered that it should be made clear that a transporter will not be required to provide services outside of the existing skill set of its staff. For example this potential purchaser considered that the condition as drafted could require emergency services to be provided to unconnected pipelines such as coal bed methane pipelines.

#### *Shipper/suppliers*

- 4.791. The key points raised by shippers/suppliers with respect to the provision of emergency services, are discussed in Chapter 3. One shipper/supplier stated that it was appropriate to continue for the moment with the present

arrangements regarding first response emergency services to IGTs and for this matter to be reviewed prior to contract expiry. However, one shipper/supplier stated that it did not consider the continuation of the present arrangements appropriate, and further respondent stated that Ofgem's proposal could have a negative impact on gas pipe-line extensions.

- 4.792. In addition, one shipper/supplier had specific comments on this licence condition. This respondent suggested that the provisions contained in this standard special condition are insufficient, as the safety case stipulation is simply to make safe, not to maintain supply. This shipper/supplier considered that an obligation to maintain supply where possible is required, together with an additional requirement to notify the relevant shipper/supplier via the affected DN where customers may have been impacted by an emergency.

*DISG comments*

- 4.793. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

**Ofgem's proposals**

- 4.794. Following consideration of respondents' views, Ofgem continues to consider that the provisions of Special Condition 19 be placed in Standard Special Condition A41 applicable to all NTS and DN-GTs.
- 4.795. The Authority will retain its discretion as to what is meant by a "major loss of supply". In relation to the views raised by a respondent that this condition should not apply to all transporters within the DN boundary, Ofgem believes that it would not be appropriate to include such a restriction within this licence condition as the existing emergency contracts are GB wide. Furthermore, Ofgem will be consulting on the arrangements for emergency response to other gas transporters in April 2005, as the present extended agreements between IGTs and Transco will be expiring by 1 April 2006.

4.796. The provisions in paragraph 3 of this condition are augmented by paragraph 13 of NTS Special Condition C1 to include provisions relating to LNG Storage. The drafting for this condition is provided for comment in Appendix 8A.

4.797. Ofgem invites respondents' views on its proposals for Special Condition 19. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Amended Special Condition 23 – Provision of Meter and Meter Reading Services***

#### **Description**

4.798. This condition requires Transco to make available the terms on which it shall provide metering services direct to the relevant supplier. It was amended in Transco's licence in line with Ofgem's RGMA reforms so that it applies to the provision of services to suppliers and not (as previously the case) shippers. This modification will help to ensure that where it becomes evident that changes to the RGMA Baseline are necessary to reflect the development of the gas metering market, these cannot be unreasonably refused by Transco.

4.799. Except in so far as the Authority agrees, the licensee shall enter into agreements with the supplier for:

- ◆ gas meters;
- ◆ metering services other than provision of gas meters (i.e. services relating to the operation of the meter); or
- ◆ meter reading services.

## **Next Steps document**

- 4.800. In the next steps document Ofgem stated that it was of the view that this special condition should become a standard special condition applicable to all NTS and DN-GTs.

## **Respondents' views**

### *NGT*

- 4.801. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

### *Potential Purchasers*

- 4.802. One potential purchaser accepted the application and the drafting of Standard Special Condition A43.

### *Shippers/suppliers*

- 4.803. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.804. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.805. One potential purchaser stated that they were not convinced that they should be forced to offer competitive market quotes for metering, as the lack of limitation of scope in this condition requires. They considered that such matters, outside the regulated business, should be for them to decide, based on commercial considerations. Another potential purchaser stated that the obligation to provide these services should be restricted to relevant suppliers. As currently drafted each licensee (each of which is a regionalised transportation business other than the NTS) is required to offer national terms for metering activities. This



purchaser did not believe that this reflects Ofgem's policy intent and that it imposed an unnecessary and inappropriate regulatory burden on all DN licensees.

- 4.806. Another potential purchaser stated that they did not believe it appropriate for the licensee to have an obligation in respect of providing terms for competitive metering and meter reading services to suppliers supplying customers connected to other DN and/or NTS operator's networks. They therefore believed that paragraph 1 should be amended to reference a "relevant supplier", and that a decision on whether to quote for such terms should be a commercial one. As previously stated however, they did not believe that IDNs should have metering obligations of last resort.

### **Ofgem's proposals**

- 4.807. Following consideration of respondents' views, Ofgem continues to believe that the provisions of Amended Special Condition 23 be placed in Standard Special Condition A43 applicable to all NTS and DN-GTs.
- 4.808. Ofgem notes the concerns expressed by potential purchasers with respect to the obligations included within this condition, but would state that, whilst the provisions of Standard Special Condition A10 relate to the meter provider of last resort services and therefore relate to the "relevant supplier" such a limitation is not appropriate with regards to the obligations within Standard Special Condition A43, which relate to the provision of competitive meter services, therefore, Ofgem considers that the drafting of Standard Special Condition A43 should remain as set out in the next steps document.
- 4.809. The drafting for this condition is provided for comment in Appendix 8A. Ofgem invites respondents' views on its proposals for Amended Special Condition 23. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 25A – Assignment of Licence***

### **Description**

4.810. Special Condition 25A requires that the licensee may only transfer its licence (either in whole or in relation to part of an authorised area or any specified pipeline system) if it:

- ◆ complies with the procedure in Section 8AA of the Gas Act; and
- ◆ obtains the prior written consent of the Secretary of State.

### **Next Steps document**

4.811. In the next steps document Ofgem detailed that it was of the view that this special condition should become a standard special condition contained in all NTS and DN-GT licences.

### **Respondents' views**

#### *NGT*

4.812. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

#### *Potential Purchasers*

4.813. One potential purchaser accepted the application and the drafting of Standard Special Condition A45.

#### *Shippers/suppliers*

4.814. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document

#### *DISG comments*

4.815. This condition was discussed at DISG 29 and DISG 34. The minutes of this meeting are attached in Appendix 2. Industry participants have therefore had the opportunity to provide detailed comments both during these meetings and by written responses after these meetings.

## **Ofgem's proposals**

- 4.816. Ofgem continues to propose that the provisions of Special Condition 25A be placed in Standard Special Condition A45 applicable to all NTS and DN GT licensees. The drafting for this condition, provided as part of the next steps document has remained unchanged, and is provided for comment in Appendix 8A.
- 4.817. Ofgem invites respondents' views on its proposals for Special Condition 25A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 26 – Prohibited procurement activities***

### **Description**

- 4.818. This condition requires that the licensee shall not enter into or otherwise acquire transportation commodities, gas or gas derivatives with the intention of selling, assigning or disposing of such assets to third parties without the consent of the Authority.
- 4.819. The prohibition does not apply where the purchase or acquisition occurs for the purposes of facilitating balancing management or constraint management, so long as the transaction is conducted on economic and efficient terms and facilitates the economic and efficient operation of the transportation system.

### **Next Steps document**

- 4.820. In the next steps document Ofgem stated that it had altered its view on how the conditions within the current Special Condition 26 should be divided between the NTS and the DNs following consideration of respondents' views. Ofgem considered that it would be most appropriate for:

- ◆ a special condition to be placed on the NTS–GT licence in relation to its role as residual energy balancer for the entire network, procurement of gas for shrinkage on the NTS, and constraint management services; and
- ◆ a standard special condition to be placed on the DN–GT licences only, in relation to shrinkage procurement (for gas lost on that DN) and constraint management services to manage congestion on that DN.

4.821. Ofgem noted that this change in its view (in that the NTS would not be subject to a standard special condition) was the result of wishing to make very clear to all parties the roles and responsibilities of the NTS and the DNs. By having a separate special condition applicable to all of Transco’s NTS activities, Ofgem believed that the clarity of Transco’s role as residual energy balancer for the entire GB system would be best preserved.

### **Respondents’ views**

#### *NGT*

- 4.822. NGT noted that Special Condition C4 required further review and pointed out that the reference to Top up Manager was now out of date.
- 4.823. However, in subsequent correspondence, NGT revised their position, on the grounds that a modification had been raised to re-introduce constrained top up (and the Top up Manager).

#### *Potential Purchasers*

- 4.824. One potential purchaser considered that the proposed drafting, which separates energy balancing from constraint management, is an appropriate approach assuming that the purchase and sale of the flexibility product is classified as constraint management.
- 4.825. Another potential purchaser welcomed the revised approach to the treatment of existing Special Condition 26, namely the inclusion of a “self contained” special condition that applies to the NTS and a standard special condition that applies to the DNs. This potential purchaser suggested that changes might have to be made to ensure that in the event that the proposed commercial flexibility product is introduced, this condition allows for it.

4.826. This potential purchaser suggested that it was more appropriate to refer to the licensee's pipe-line system (or each of its pipe-line systems) rather than the GB transmission system in this instance since DNs would not be managing constraints or shrinkage for systems other than their own.

*Shippers/suppliers*

4.827. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

*DISG comments*

4.828. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

4.829. NGT raised the issue concerning whether the NTS and RDNs could jointly purchase shrinkage gas, as it would assist in achieving economies of scale. NGT stated that it considers such a prohibition to be inappropriate for three reasons:

- ◆ NGT would be disadvantaged compared to the DN buyers who will no doubt procure through their own affiliate supply companies on an arms length basis;
- ◆ joint procurement by NGT and DNs poses no risk of unfair competition or undue discrimination - the procurement of shrinkage is transparent to the market, and costs are clearly attributable to NTS and each DN;
- ◆ the loss of this facility would lead to a loss of economies of scale and the introduction of additional costs for the DN business to set up its own parallel capabilities; the costs of which cannot in the circumstances be justified.

4.830. A potential purchaser highlighted that DNs might not be managing constraints but that they might be trading for competitive reasons and considered that DNs should be able to trade in any excess capacity that they have.

4.831. This potential purchaser also stated their preference for removing references to Top Up manager.

4.832. Another potential purchaser stated that to the extent that this condition was to make provision for the proposed NTS exit reform, they were concerned that this condition would prevent the DN from buying/selling flow flexibility and/or NTS capacity rights in order to manage efficiently its NTS exit capacity profile and flow flexibility requirements as envisaged, since, in doing so, it would not necessarily be managing a constraint. This potential purchaser therefore believed that trading of the proposed new exit and flexibility products should be carved out from this restriction.

### **Ofgem's proposals**

4.833. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting consulted upon in the next steps document, which include, but are not limited to, the following:

- ◆ to the NTS Special Condition C4:
  - ◆ to clarify (in paragraphs 1 and 2) that the licensee, in the case of Transco plc's NTS business, may not enter into agreements for or otherwise acquire transportation commodities, gas or gas derivatives on the account of the RDN business and vice versa;
  - ◆ the removal of definitions that are now included in Standard Special Condition A3: "capacity rights", "constraint management", "derivative" and "NTS"; and
- ◆ to the DN Standard Special Condition D4:
  - ◆ to clarify (in paragraphs 1 and 2) that the licensee, in the case of Transco NTS business, may not enter into agreements for, or otherwise acquire transportation commodities, gas or gas derivatives on the account of the RDN business and vice versa;
  - ◆ the removal of definitions that are now included in Standard Special Condition A3: "capacity rights", "constraint management", and "derivative"; and

- ◆ modification to the definition of “shrinkage procurement” such that common procurement for shrinkage purposes is permitted across affiliated Distribution Networks (but not across the NTS and the Distribution Networks).

- 4.834. Ofgem has taken full account of respondents’ views, however, would state that in relation to the joint purchase of shrinkage gas by the NTS and the RDNs, it considers that it is important to retain separation in this area to allow comparisons across DNs (and the potential for driving further efficiencies). As discussed earlier in this chapter, the references to Top up contained within the definition of ‘balancing management’ and, now within Standard Special Condition A3 are being retained following a recent modification raised by Transco to reinstate Top-up.
- 4.835. Ofgem therefore proposes that the provisions of Special Condition 26 be placed, subject to the modifications above, in Standard Special Condition D4 applicable to all DN-GTs, and Special Condition C4 applicable to the NTS licensee. The revised drafting for these conditions is provided for comment in Appendices 8D and 8C respectively.
- 4.836. Ofgem invites respondents’ views on its proposals for Special Condition 26. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 27 – Licensee’s procurement and use of system management services***

### **Description**

- 4.837. This condition requires the licensee to operate the NTS in an efficient, economic and co-ordinated manner and prohibits undue discrimination or undue preference in procurement or use of system management services. It also places reporting obligations to the Authority on the licensee.

## Next Steps document

4.838. In the next steps document Ofgem stated that following consideration of respondents' views, it considered that separate licence conditions should be put in place obliging licensees to operate their system in an efficient, economic and co-ordinated manner and prohibiting undue discrimination. Ofgem agreed with Transco's view that the standard special condition in DN-GT licences should be narrower in scope than the special condition applicable to the NTS. As such, Ofgem proposed that a narrower definition of "system management services" should be applied to the DNs than the NTS. Therefore in the next steps document Ofgem set out that:

- ◆ in the NTS special condition system management services should be defined to include balancing of the NTS, including balancing trades, as well as constraint management and NTS shrinkage; whereas
- ◆ in the DN-GT standard special condition, system management services should be defined to include procurement of gas to replace that lost in the licensee's pipeline system and constraint management only.

4.839. Ofgem considered that it would not be within the scope of the DN sales process to extend this condition to cover IGTs.

4.840. In the next steps document Ofgem also detailed that Paragraph 2 of the proposed Special Condition C5 and Standard Special Condition D5 set out that the "licensee shall neither unduly discriminate nor unduly prefer in its procurement or use of system management services as between any persons or classes of persons". As Transco would retain its NTS and DN businesses within a single legal entity, Ofgem stated that each business would be an internal business unit of a single company and therefore may not be subject to the provisions of paragraph 2 as drafted. Ofgem therefore considered that it could be necessary to amend these conditions so that Transco's NTS business would also be prevented from unduly discriminating in favour of the Transco RDN business units and vice versa. Ofgem set out its intention to discuss this matter further through the DISG.



## **Respondents' views**

### *NGT*

- 4.841. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

### *Potential Purchasers*

- 4.842. One potential purchaser remained of the view that the reporting requirements of this condition are onerous at the DN level, relating as they do to what are likely to be a small number of call off contracts for gas for constraint management purposes. However, this potential purchaser accepted the application and the drafting of Standard Special Condition D5, hoping that in its application the proportionality of the relevant provisions, set against the services required and reported against, is sensible.
- 4.843. One potential purchaser considered that this condition was unnecessarily onerous for DN purposes. This potential purchaser suggested that the original condition was primarily associated with the NTS activities and therefore it was not necessary to apply such rigorous auditing and reporting requirements to the DNs.

### *Shippers/suppliers*

- 4.844. No shipper/supplier provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.845. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 32 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.
- 4.846. One potential purchaser accepted the constraints that Ofgem wished to impose on DNs, but was concerned that the draft might be overly restrictive.

4.847. Another potential purchaser noted that consistent with their response submitted in December, they believed that under the existing DN arrangements the provisions of this condition were too onerous. The original condition was primarily associated with the NTS activities and they therefore did not believe that it was necessary to apply such rigorous auditing and reporting requirements on the DN. They believed that in doing so, Ofgem is inappropriately pre-empting a DN exit reform.

4.848. This potential purchaser was also unsure whether NGT would be required to prepare and have audited separate statements for each of its RDNs or whether a “composite” statement would be required. For transparency, they believed that separate statements for each of the RDNs would be appropriate.

### **Ofgem’s proposals**

4.849. Following consideration of respondents’ views, Ofgem has made a number of modifications to the drafting consulted upon in the next steps document, which include, but are not limited to, the following:

- ◆ to the NTS Special Condition C5:
  - ◆ changes to reflect the fact that DN operators should be consulted when there is a potential impact upon NTS exit capacity or NTS exit flow flexibility (in paragraphs 6(c), 8(a) and 8(b)) consistent with the DTI’s proposals for a Gas Act exemption; and
  - ◆ the removal of definitions that are now included in Standard Special Condition A3: “appropriate auditors”, “capacity rights”, “constraint management services”, “derivative” and “NTS”.
- ◆ to the DN Standard Special Condition D5:
  - ◆ changes (to paragraph 7) to reflect the fact that DN operators should consult the NTS operator, consistent with the DTI’s proposals for a Gas Act exemption; and
  - ◆ the removal of definitions that are now included in Standard Special Condition A3: “appropriate auditors”, “capacity rights”, and “constraint management services”.

- 4.850. Ofgem therefore proposes, as far as is applicable given differences in the allocation of roles and responsibilities between the NTS and DNs, that the provisions of Special Condition 27 be placed, subject to the modifications above, in Standard Special Condition D5 applicable to all DN-GTs, and Special Condition C5 applicable to the NTS licensee. The revised drafting for these conditions is provided for comment in Appendices 8D & 8C respectively.
- 4.851. Ofgem invites respondents' views on its proposals for Special Condition 27. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 28A – Revenue restriction definitions***

### **Description**

- 4.852. This condition defines a number of terms in the revenue restrictions.

### **Next Steps document**

- 4.853. In the next steps document Ofgem stated that it was publishing a formal section 23 notice in conjunction with the informal 8AA consultation which detailed its intention to change this condition for the purposes of separating the price controls between Transco's NTS and each of its DNs.
- 4.854. Ofgem set out that it would be necessary to change further this condition to:
- ◆ ensure that the use of the term "shipper" within the NTS Special condition was appropriate given Option 2A for offtake arrangements;
  - ◆ enable the revenue adjustments required in respect of DN-GTs for the purposes of Option 2A for offtake arrangements;

- ◆ develop incentives on NTS and DN-GTs to support the NTS offtake arrangements;
- ◆ introduce a “safety net” to ensure that customers would be protected in the event that costs exceed benefits and retained until the end of the process; and
- ◆ develop proposals that would be robust to the separation of the networks from Transco.

4.855. The proposed new special conditions that would be introduced pursuant to the formal section 23 notice (subject to respondents’ views) would therefore need substantial amendment at the section 8AA notice stage. Ofgem highlighted that it would be publishing drafting to support these amendments in the near future and that it would be discussed at the DISG. Ofgem also clarified that the views of respondents’, received in response to the September document, would be considered as part of this process.

### **Respondents’ views**

4.856. As discussed in Chapter 3, most respondents who commented on this issue expressed their support for Ofgem’s proposals in this area.

#### *NGT*

4.857. NGT’s key comments in relation to price controls and incentive arrangements are summarised in Chapter 3.

#### *Potential Purchasers*

4.858. Key comments made by potential purchasers in relation to price controls and incentive arrangements are summarised in Chapter 3. One potential purchaser agreed that the price controls should not be reopened, that the initial duration of any DN level incentive scheme should be for one year, and that a safety net should be introduced. Another potential purchaser agreed that it would be necessary to adapt the price control conditions to reflect the fact that DNs will be passing through NTS charges to shippers and to reflect Ofgem’s proposal to introduce an incentive regime in relation to the NTS/DN interface.

4.859. In addition one potential purchaser stated on this licence condition that they supported the proposals in principle but were awaiting detailed drafting proposals before commenting further. One potential purchaser queried whether it was appropriate to include a number of NTS related definitions, within the DN licences. This potential purchaser also queried whether “storage connection point” should be an NTS only definition.

*Shippers/suppliers*

4.860. Key comments made by shippers/suppliers in relation to price controls and incentive arrangements are summarised in Chapter 3. One shipper/supplier had a number of comments on the proposed drafting of this licence condition. This shipper/supplier suggested that definitions of gas shippers, Distribution Network Operator, Transco's Network Code and volume related definitions associated with Special Condition C8A had been omitted. This shipper/supplier also suggested that references to Top up Manager needed to be removed.

4.861. This shipper/supplier also considered that on the definition of NTS flow flexibility, it was not clear whether this should be related to or accompanied by a definition of NTS baseline flow flexibility for completeness.

*DISG comments*

4.862. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 33 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

4.863. In DISG discussions, NGT has expressed opposition to Ofgem proposals to adjust the price control drafting with respect to the summation of DNK terms (the revenue adjustment factor for DN revenue over or under-recovery) such that each of the RDNs is treated separately. A potential purchaser queried the proposed drafting of the definitions of “NTS baseline firm exit capacity” and “NTS baseline firm interruptible capacity”, which referred to modification of these baselines in accordance with Standard Special Condition A4 (Charging –

General). This potential purchaser expressed concern that these baselines could be subject to modification in such a way.

### **Ofgem's proposals**

4.864. Following further consideration of these issues including respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, the following:

- ◆ the removal of a number of definitions which have been included within Standard Special Condition A3 (Definitions and Interpretation), with examples including: "appropriate auditors", "NTS", "NTS exit capacity", and "NTS shrinkage";
- ◆ a number of definitions have been modified, including:
  - ◆ "supply of Distribution network services", such that it is consistent with the changes to "supply of transportation services" in Standard Special Condition A3, and the allocation of roles and responsibilities, consistent with Standard Special Condition C4 and Standard Special Condition D4;
  - ◆ the definition of "NTS SO activity", such that, instead of referring to "entry capacity constraint management services" and "exit capacity constraint management services", references are made to "constraint management services", which is a term defined in Standard Special Condition A3, and instead of referring to "system balancing services" reference is made to "balancing management";
  - ◆ "transportation system" such that it is clear that this term refers to the transportation system to which this licence relates;
  - ◆ in the NTS licence: the definition of "plus 15 curtailment day" has been modified such that it is related to the transportation system to which the licence relates;

- ◆ in the DN licences: the definition of “LDZ capacity curtailment rights” has been removed and replaced with a definition of “Distribution Network capacity curtailment rights”;
- ◆ “NTS baseline firm exit capacity” and “NTS baseline firm interruptible capacity” such that modification of the baselines can only occur with the prior written consent of the Authority;
- ◆ the removal of further definitions that are no longer required:
  - ◆ “shipper”, (which previously included GTs with an exemption to the Gas Act) has been removed, and all references are to “gas shipper” throughout the licence, consistent with the Gas Act definition – as a result, DN operators or NTS operators are referred to directly as appropriate;
  - ◆ “system balancing services”, which has been removed as it was defining the same activity as the term “balancing management” which is now defined in Standard Special Condition A3;
  - ◆ “entry capacity constraint management services” and “exit capacity constraint management services”, consistent with the change to “NTS SO activity” outlined above;
  - ◆ “NExA”, which was a term used within the definition of “exit capacity constraint management services”, which has been deleted as outlined above;
  - ◆ “audit” which is not used in the price control conditions; and
- ◆ the insertion of a number of definitions within the NTS licence, such as “NTS baseline exit flow flexibility” and “NTS incremental exit flow flexibility”.

4.865. Whilst some definitions have been deleted from one or other of the NTS or DN licences on the grounds that they are DN or NTS specific, respectively, it is noted that it has been necessary to retain a number of NTS definitions within the DN licences and vice versa. This is largely caused by the fact that, in the allocation of prescribed rates in Special Condition C8B and Special Condition

E2B, it is necessary to refer to both the NTS and DN businesses, and a number of related definitions cascade out of the definitions applied. Ofgem would note that the allocation of prescribed rates is an issue for all six of Transco's licence in the period to share sale, but notes that it may be possible to perform some rationalisation of the definitions included within the IDN licences following share sale.

- 4.866. Furthermore, in a number of cases, definitions have been clarified for consistency with the proposed drafting of the UNC and the terms defined within it. Ofgem notes, that should any inconsistencies between the licence and the UNC become apparent in this respect, these will be corrected as part of a further section 23 process subsequent to hive-down.
- 4.867. Consistent with the approach to Top up applied in the definition of "balancing management" in Standard Special Condition A3, references to Top up have been retained given the modification recently raised by Transco in this regard.
- 4.868. Ofgem therefore proposes that the provisions of Special Condition 28A within each DN licence be placed, subject to the modifications above, in Special Condition E2A applicable to the relevant DN GT licensees, and that the provisions of Special Condition 28A within the NTS licence be placed in Special Condition C8A. The revised drafting for these conditions is provided for comment in Appendices 8E(1) to (5) & 8C respectively.
- 4.869. It is noted that these conditions will be subject to further change as part of a further section 23 process subsequent to hive-down to reflect the proposed incentive regimes and arrangements for offtake. It is therefore envisaged that additional terms will be introduced to reflect these proposed incentives, as well as proposals for the introduction of an interruptible product.
- 4.870. Ofgem invites respondents' views on its proposals for Special Condition 28A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.



***Special Condition 28B – Restriction of revenue in respect of the NTS transportation owner activity, Distribution Network transportation activity and NTS system operation activity.***

**Description**

4.871. This condition defines the price controls and incentives applicable to Transco.

**Next steps document**

4.872. In the next steps document Ofgem stated that it was giving notice of its intention to modify this condition such that separate special conditions would apply to each DN and NTS licensee. Ofgem was of the opinion that these special conditions would ensure that the separate price controls were applicable to each of the individual DNs and the NTS through licensing arrangements<sup>42</sup>.

4.873. Ofgem also explained that, similarly to Special Condition 28A, a number of further modifications to this condition were envisaged.

4.874. Ofgem outlined that the proposed new special conditions that would be introduced would need substantial amendment at the section 8AA notice stage. Ofgem set out that it would be publishing drafting in relation to these amendments to be discussed at the DISG meetings. Ofgem clarified that the points raised by respondents, in response to the September document, would be considered as part of this process.

4.875. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members, and as such, a number of DISG members included comments on this drafting in their formal responses.

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<sup>42</sup> Independent of the DN Sales consultation process, Ofgem published a separate notice on its decision to change paragraph 14(11) of this condition at the same time as the section 23 notice accompanying this document was published. If the changes to paragraph 14(11) are made, these will need to be reflected in the licence conditions being modified for the Section 8AA consent (and associated section 23 notice).

## **Respondents' views**

### *NGT*

- 4.876. NGT's key comments in relation to price controls and incentive arrangements are summarised in Chapter 3.

### *Potential Purchasers*

- 4.877. One potential purchaser noted that further changes were being considered by Ofgem.

### *Shippers/suppliers*

- 4.878. One shipper/supplier requested clarification on why terms such as DREVBExCt, REVIEExCt, REVIFFt, REVBFFt, DREVBFFt and others as well as the proposed addition of table A5 in Schedule A are required in the current price control. This shipper/supplier also suggested that the definition of TOExRt refers to NTS baseline firm exit capacity and NTS flow flexibility, and it may be that both should be the "baseline" quantities.
- 4.879. This shipper/supplier also suggested that as NTS flow flexibility is to be held/acquired by DNs within this price control period it should be calculated and reported separately rather than being included within the DNEXCt term.
- 4.880. This shipper/supplier also suggested that the grouping of K factors for interest rate purposes where the licensee and its affiliates together own more than one DN should not be permitted as this is inconsistent with the principles of price control separation and weakens the incentives on the DNs to minimise K.

### *DISG comments*

- 4.881. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. We append the minutes of these meetings in Appendix 2 for information.

4.882. One potential purchaser noted that if the DN is going to use reasonable endeavours to only change prices once per year, the figures of 4% and 6% over-recovery where penalties apply in paragraph 6(2) should be increased. In addition, this potential purchaser was concerned that post sale customers would benefit at the expense of DNs in those years where some DNs over-recover and some under-recover as a result of the interest rate received for under-recovery being 3% less than the interest rate paid for over-recovery. Therefore this potential purchaser suggested that this interest rate differential should be reduced.

### **Ofgem's proposals**

4.883. As discussed in Chapter 2, on 26 January 2005, Ofgem directed changes to the Income Adjusting Event provisions of Transco's licences. Following this direction, Ofgem issued, on 1 February 2005, a further direction to separate the price control provisions between Transco's six licences, as proposed in Chapter 3 of the next steps document. As a result:

- ◆ each of Transco's six licences contained price control provisions specific to that licence; and
- ◆ new Income Adjusting Event provisions are now operative in Transco's NTS licence.

#### *NTS licence*

4.884. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, the following, within the NTS licence:

- ◆ changes to the principal formulae for actual NTS TO revenue and NTS SO revenue to reflect the changing source of NTS revenues once the enduring offtake arrangements come into effect;

- ◆ introduction of the customer safety net, consistent with the estimation of the value of this safety net within Ofgem's Final IA<sup>43</sup> and the Authority's conditions of consent in this regard<sup>44</sup>;
- ◆ the removal of references to universal firm; and
- ◆ changes to the allocation of prescribed rates to reflect the fact that the prescribed rates bill for Transco plc will need to be allocated across fewer Transco businesses following the sale of four of its DNs.

4.885. As stated above, Ofgem proposes to change the principal formulae for NTS TO revenue and NTS SO *actual* revenue to reflect the changing source of NTS revenues once the enduring offtake arrangements come into effect. However, it should be noted that the principal formulae with respect to maximum or allowed revenue remain unchanged in this regard (with the exception of safety net proposals discussed below) and therefore, charges to customers will remain unchanged for the duration of this price control. The NTS principal formulae for actual revenue have been modified as follows:

- ◆ in the case of the NTS transportation owner revenue principal formula (for actual revenues):
  - ◆ a new term has been introduced for 2005/6 onwards (TOExNTSSIC) to reflect the revenue derived by the licensee from the sale of NTS baseline firm exit capacity and NTS baseline exit flow flexibility (less the revenue from the sale of on the day NTS baseline firm exit capacity and NTS baseline exit flow flexibility); and
  - ◆ it should be noted that the two terms that already exist within this principal formula (TOExRF and TOExNTSSIC) will continue to apply, but will, from 1 October 2008 (or such later date as the Authority directs) become zero values, as such, when the enduring arrangements come into effect, the existing terms of this

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<sup>43</sup> *National Grid Transco – Potential sale of gas distribution businesses – Final Impact Assessment* - November 2005 – 255/04a.

<sup>44</sup> *National Grid Transco – Sale of gas distribution networks - Authority decision. Transco plc application to dispose of four gas distribution networks.* February 2005 – 21/05

formula will cease to have effect, and the new term (TOREVBExC) will become non-zero; and

- ◆ in the case of the NTS system operation revenue principal formula (for actual revenues):
  - ◆ four new terms have been introduced for 2005/6 onwards (DREVBExC, REVIExC, DREVBFF and REVIFF) to reflect the revenue derived by the licensee from the sale of on the day NTS baseline firm exit capacity and NTS baseline exit flow flexibility and the sale of NTS incremental exit capacity and NTS incremental exit flow flexibility; and
  - ◆ it should be noted that the two terms that already exist within this principal formula (TOEx and TOExRF) will continue to apply, but will, from 1 October 2008 (or such later date as the Authority directs) become zero values, as such, when the enduring arrangements come into effect, the existing terms of this formula will cease to have effect, and the new terms will become non-zero.

4.886. As stated above, the only change to the NTS principal formulae for maximum revenue is the introduction of the safety net into the principal formula for NTS TO revenue. In Ofgem's Final IA, it was estimated that if the DN sales transaction created only one new comparator i.e. only one DN was sold by Transco, or all of the DNs were sold to only one corporate entity, then the net detriment to customers would be £16.3m. As a result, Ofgem is proposing a safety net (consistent with Ofgem's conditions of consent) such that, on 1 April 2007, in the event that only one comparator is created through the proposed transaction, the NTS allowed revenue shall be reduced by £16.3m (inflated from 2004 prices). This is reflected by the proposed changes to the TOK term.

4.887. Furthermore, references to "universal firm", and the reasonable endeavours obligation upon the licensee to ensure universal firm registration have been removed from the NTS licence as these are no longer applicable.

4.888. The treatment of the allocations of prescribed rates in both the NTS and DN licences is discussed in the context of all licences below.

## *DN licences*

4.889. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, the following, within the DN licences:

- ◆ changes to the principal formula for maximum allowed revenue to reflect the fact that charges for NTS exit capacity and NTS exit flow flexibility will be passed through from the NTS, through DNs, to shippers;
- ◆ amendments to reflect the fact that DNK terms should not be summed across DNs before application of the penal interest rate for over-recovery of revenue, consistent with Ofgem's general policy of price control separation of the RDNs; and
- ◆ changes to the allocation of prescribed rates to reflect the fact that the prescribed rates bill for Transco will need to be allocated across fewer Transco businesses following the sale of four of its DNs.

4.890. As stated above, Ofgem proposes to change the principal formula for the Distribution Network transportation activity maximum revenue to reflect the Option 2A revenue flows whereby charges for NTS exit capacity and NTS exit flow flexibility will be passed through the DNs to shippers, and as such, it is necessary to increase the maximum allowed revenue in this regard to reflect the pass through of these costs.

4.891. The DN principal formula for maximum revenue has been modified to introduce a new term (DNExC) from 2005/6 onwards to reflect the actual payments made by the licensee in respect of NTS exit capacity (DNExCC) and NTS exit flow flexibility (DNExFFC), net of any revenues received from the NTS operator by the licensee in respect of these products. Therefore, as and when such payment flows become non-zero, the maximum allowed revenue of the DNs will increase to allow the pass through of such costs. As stated above, it is anticipated that these payment flows will remain zero until 1 October 2008 as discussed in the interim incentives document which Ofgem intends to publish at the beginning of May 2005.

- 4.892. Furthermore, it has come to Ofgem's attention that a minor typographical error was introduced into the licence of the Wales and West IDN as part of the 1 February section 23 direction, such that the DNK on 1 April 2004 was £2,204,783 when it should have been £2,204,793. This has been corrected in the drafting included in Appendix 8E(5).
- 4.893. As discussed earlier in this chapter, and in Chapter 3, Transco's proposed pricing consultation may result in further charges being passed through DNs from the NTS to shippers. Should such changes be required, these will be made as part of a section 23 licence modification process subsequent to hive-down.
- 4.894. As stated above, further changes have been made to the DN licences to reflect the fact that from 2005/6, DNK terms should be assessed separately for each DN, and the penal interest rate applied to revenue over-recovery as appropriate (rather than summing revenue over-recovery and under-recovery across networks before applying such penal interest rates). Whilst this change has been made to all DN licences, it should be noted that this change will only have an impact upon Transco's RDN business as this is the only business that holds more than one DN within the same licence.
- 4.895. In the licences to be retained by Transco (i.e. the NTS and RDN licences) it has been necessary to make adjustments to the allocation of prescribed rates to reflect the fact that the rates bills received for Transco as a whole, will need to be allocated across fewer businesses following the sale of four of Transco's Distribution networks.

*Treatment of prescribed rates*

- 4.896. The Transco network is assessed for non-domestic rates on central rating lists held by the Office of the Deputy Prime Minister, in respect of England, and the Welsh and Scottish Assembly, in respect of Wales and Scotland respectively. Transco currently has one rateable value for the English operational property, one for Wales, and one for Scotland. From 1 April 2005, the rateable values will be revised, in line with all rateable values, as a result of the 2005 revaluation. Furthermore, Transco's meters will be split from their network and will appear separately on the central lists.

- 4.897. When Transco sells the four DNs outside the NGT Group the rateable values will again be split. Each IDN will then, from the date of the sale, have two separate rateable values on the central list - one for their network and, if applicable, for any meters attached to their network. The remainder of the Transco network will stay in a single, but reduced, rateable value (one for England, one for Wales and one for Scotland) and the meters attached to the retained DNs in England will also remain in a single, but reduced, rateable value.
- 4.898. Transco's rateable value has been assessed by the Valuation Office Agency (VOA). The receipts and expenditure valuation model examines the DNs, the NTS and the metering businesses on a bottom-up approach so as to generate stand alone valuations for each part. The rateable values of the NTS and the Wales and West DN were then split between England, Wales and, in the case of the NTS, Scotland, by reference to pipeline length in the respective businesses.
- 4.899. The VOA model has been used to establish percentages for the allocation of Transco's prescribed rates bills across its retained businesses following share sale such that:
- ◆ the rates bills for Scotland and Wales are allocated to the NTS (following the sale of the Scottish and Welsh DNs); and
  - ◆ the rates bill for England is allocated between Transco's NTS and RDNs on the basis of percentages derived from the VOA model.
- 4.900. Application of the VOA model in this regard ensures consistency between the allocation of Transco's rates bill between its businesses and the rates bills determined for the IDNs following share sale.
- 4.901. Furthermore, in the relevant sections on prescribed rates within the NTS and DN licences respectively, rather than repeating the provisions of Special Condition C9 and Special Condition E3 respectively, a cross-reference is provided to these conditions.

*Comments invited*

- 4.902. Ofgem's proposals for the revision of Special Standard Condition 28B are set out in Appendices 8E and 8C respectively for comment.



4.903. Further changes to the price control conditions will be required as part of two further section 23 consultations in respect of all NTS and DN-GT licences that will occur following hive-down of the four relevant DNs from Transco to its four relevant wholly owned subsidiary companies:

- ◆ the first of these is planned for May 2005 and will seek to implement changes to incorporate (amongst other things):
  - ◆ the interim incentive arrangements - these changes will include consideration of an incentive regime upon the DNs to address the removal of the > 15day curtailment rights incentive as part of the 1 February section 23 modification, and will also include the introduction of Income Adjusting Event provisions within the DN licences to accompany the suite of incentives introduced. Furthermore, modifications will be required to address issues such as the introduction of an interruptible product, and revenue flows between the NTS and DN operator;
  - ◆ changes required to reflect the outcome of Transco's pricing consultations, for example, if the TO or SO commodity charges are to be passed through the DNs then changes will be required; and
  - ◆ changes may be required to ensure that charging and revenue recovery is consistent with the DTI's proposed alternative arrangements for independent systems.
- ◆ the second section 23 consultations is planned for July 2005 following sale of the shares in the four relevant wholly owned subsidiary companies by Transco to third party purchasers and will seek (amongst other things) to implement the enduring incentive arrangements.

4.904. As stated in Chapter 3, Ofgem is not proposing to introduce a dead-band into either the NTS or DN licences at this time. However, this issue will be reconsidered at the next price control reviews.

4.905. Ofgem invites respondents' views on its proposals for Special Condition 28B. The drafting for this condition is provided for comment in Appendix 8B. Ofgem

notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 29 – Allocation of revenues and costs for calculation under the price control***

### **Description**

- 4.906. This condition sets out the licensee's obligations regarding the allocation or attribution of revenues, costs, assets and liabilities by the licensee in order to calculate values referred to in Special Condition 28B.

### **Next Steps document**

- 4.907. In the next steps document Ofgem stated that it considered that the provisions of this condition should be contained in a special condition for each licensee, linked to the revenue restriction condition and amended to reflect the relevant activities of each licensee.
- 4.908. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members and, as such, a number of DISG members included comments on this drafting in their formal responses.

### **Respondents' views**

#### *NGT*

- 4.909. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document

#### *Potential Purchasers*

- 4.910. One potential purchaser accepted the application and the drafting of Special Condition E3.

### *Shippers/suppliers*

- 4.911. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document

### *DISG comments*

- 4.912. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.913. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, cross-reference changes and the deletion of the definition of "appropriate auditors" which is now contained in Standard Special Condition A3.
- 4.914. Ofgem therefore proposes that the provisions of Special Condition 29 be placed in Special Condition E3 applicable to the relevant DN-GTs, and Special Condition C9 applicable to the NTS licensee and amendments.
- 4.915. In each licence, the formatting of sub-paragraph 1(b)(ii) has been clarified by:
- ◆ re-formatting the pre-existing text into further sub-bullets;
  - ◆ clarifying the drafting of the newly created sub-bullet (bb); and
  - ◆ in the case of Transco's NTS and RDN licences, adding a further sub-bullet to ensure that allocation and attributions do not unduly benefit one or more of Transco's RDNs.
- 4.916. Furthermore, the definition of "metering activities" has been removed from these conditions, as it now appears in Standard Special Condition A3 (Definitions and Interpretation). The revised drafting for these conditions is provided for comment in Appendices 8E & 8C respectively.

- 4.917. Ofgem invites respondents' views on its proposals for Special Condition 29. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition 30 - Supplementary provisions of the revenue restrictions***

#### **Description**

- 4.918. This condition sets out activities that can be treated as excluded services and defines charges or proportions of charges which can be treated as excluded revenue. These include last resort payment claims, supplemental charges, emergency service charges, charges relating to gas illegally taken or works at connection points.

#### **Next Steps document**

- 4.919. In the next steps document Ofgem considered that the provisions of this condition should be contained in a special condition for each licensee, linked to the revenue restriction condition and amended to reflect the relevant activities of each licensee. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members and, as such, a number of DISG members included comments on this drafting in their formal responses.

#### **Respondents' views**

*NGT*

- 4.920. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

*Potential purchaser*

- 4.921. One potential purchaser accepted the application and the drafting of Special Condition E4.

*Shipper/supplier*

- 4.922. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

*DISG comments*

- 4.923. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

**Ofgem's proposals**

- 4.924. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, changes to cross-references and the removal of references to Standard Condition 4C which is time-expired and will be switched off.
- 4.925. Ofgem therefore proposes that the provisions of Special Condition 30 be placed, subject to the modifications above, in Special Condition E4 applicable to the DN-GTs, and Special Condition C10 applicable to the NTS licensee with amendments. The revised drafting for these conditions is provided for comment in Appendices 8E & 8C respectively.
- 4.926. Ofgem invites respondents' views on its proposals for Special Condition 30. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the

conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Amended Special Condition 31 – Restriction of Prices in Respect of Tariff Capped Metering Activities***

#### **Description**

- 4.927. This condition sets tariff caps for metering activities which can be increased in line with the Retail Prices Index, with a claw back for 2005, and specifies the maximum, indexed tariff cap values for charges for different metering activities.

#### **Next Steps document**

- 4.928. In the next steps document Ofgem stated that the provisions of Amended Special Condition 31 should be included within special conditions for each licensee and set out that this would be consistent with the treatment of the other key price control related conditions. However, Ofgem considered that it would not be appropriate, as part of the DN sales project, to change any of the provisions of Amended Special Condition 31 and that, as such, the provisions included within these special conditions should be the same for all NTS and DN-GTs. Ofgem set out that its view was that it would not be appropriate to differentiate between RDN and IDN-GTs with respect to regulated metering obligations.

#### **Respondents' views**

##### *NGT*

- 4.929. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

##### *Potential Purchasers*

- 4.930. One potential purchaser accepted the application and the drafting of Special Condition E5.

#### *Shippers/suppliers*

- 4.931. One shipper/supplier asked for clarification regarding the inclusion, within the drafting of the condition, of a reference to the term  $R_t$  in paragraphs 3 and 4 which appeared to only apply to the formula year commencing 1 April 2005.

#### *DISG comments*

- 4.932. The drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

#### **Ofgem's proposals**

- 4.933. Ofgem remains of the opinion that the provisions of Amended Special Condition 31 should be included within special conditions for each licensee, and that this would be consistent with the treatment of the other key price control related conditions. Ofgem also considers that it would not be appropriate, as part of the DN sales project, to change the provisions of Amended Special Condition 31 and that, as such, the provisions included within these special conditions should be the same for all NTS and DN-GTs. Ofgem further confirms its view that it would not be appropriate to differentiate between RDN and IDN-GTs with respect to regulated metering obligations and the price control charges for the services under these licence obligations.
- 4.934. Ofgem therefore proposes that the provisions of Amended Special Condition 31 be placed in Special Condition E5 applicable to the relevant DN-GTs, and Special Condition C12 applicable to the NTS licensee. The revised drafting for these conditions is provided for comment in Appendices 8E and 8C respectively.
- 4.935. Ofgem invites respondents' views on its proposals for Amended Special Condition 31. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement

of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition 32 – Non-discrimination in the provision of metering activities***

#### **Description**

- 4.936. This condition requires the avoidance of undue discrimination in the provision of metering activities.

#### **Next Steps document**

- 4.937. In the next steps document Ofgem considered that it would be inappropriate to differentiate between RDN and IDN-GTs with respect to regulated metering obligations and therefore was of the opinion that these obligations should be subject to the non-discrimination provisions contained in this condition. As such, Ofgem was of the view that this condition should be included as a standard special condition in all NTS and DN-GT licences.

#### **Respondents' views**

##### *NGT*

- 4.938. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

##### *Potential Purchasers*

- 4.939. One potential purchaser accepted the application and the drafting of Standard Special Condition A46. Another potential purchaser considered that references to gas shippers should refer to the gas suppliers.

##### *Shippers/suppliers*

- 4.940. One shipper/supplier suggested that the reference to shippers should, in fact, be to suppliers, following the RGMA drafting changes.



### *DISG comments*

4.941. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

4.942. Following consideration of the responses received Ofgem agrees that an RGMA related change was overlooked during the RGMA project. As such, changes to this condition include, but are not limited to, changing references to "shipper" to "supplier" throughout this condition.

4.943. Ofgem has therefore placed, subject to the modifications above, the provisions of Special Condition 32 in Standard Special Condition A46 applicable to all NTS and DN GT licensees. The revised drafting for this condition is provided for comment in Appendix 8A.

4.944. Ofgem invites respondents' views on its proposals for Special Condition 32. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 33 – Information to be provided to the Authority in connection with the transportation system revenue restriction***

### **Description**

4.945. This condition requires the licensee to provide information statements to the Authority in connection with its transportation system revenue restriction.

## **Next Steps document**

- 4.946. In the next steps document Ofgem stated that it remained of the view that this condition should be split appropriately for the NTS and DN-GTs' licence conditions, and amended to provide separate tables for each DN with appropriate adjustments to price control references. Therefore, Ofgem considered that this condition should be separated into Special Conditions for each NTS and DN-GT licence.
- 4.947. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members and, as such, a number of DISG members included comments on this drafting in their formal responses.

## **Respondents' views**

### *NGT*

- 4.948. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.949. One potential purchaser accepted the application and the drafting of Special Condition E6.

### *Shippers/suppliers*

- 4.950. One shipper/supplier suggested that changes might be required to reporting requirements if there were further amendments to the price control formulae as a result of the exit proposals. This shipper/supplier suggested that the definition of TOREVBExCt in the reporting table does not appear to match the definition of the same term in the main text, and TOREVFFt appears in the reporting table but not in the text. This shipper/supplier also suggested that it may also be helpful to consider a requirement to report EXDNIICt.
- 4.951. This shipper/supplier also stated that the drafting supplied at DISG related to the Scotland DN; however, where more than one DN is owned by a single licensee, it is important that all such reporting should be at a DN level, and hence that the

title should be amended to refer to information to be provided to the Authority in respect of each distribution network.

*DISG comments*

4.952. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

**Ofgem's proposals**

4.953. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, the following:

- ◆ in the NTS licence: the inclusion of two additional terms within the NTS transportation owner activity table (REVBExC and REVBFF) to reflect the changes to the actual revenue principal formula for the TO; and
- ◆ in the DN licences: the inclusion of two additional terms within the DN transportation activity table (DNExCC and DNExFFC) to reflect the changes to the maximum revenue principal formula.

4.954. Ofgem notes that these conditions will be subject to further change as part of a further section 23 process subsequent to hive-down to reflect the proposed incentive regimes and arrangements for offtake. At this time, Ofgem proposes to conduct a full review of the information reporting requirements within this condition to ensure that information in respect to all appropriate price control terms is provided.

4.955. Furthermore, Ofgem would note that this condition within the RDN licence clearly states, in paragraph 1, that information should be provided in respect of each Distribution Network. Similarly, in the NTS licence, paragraph 1 clarifies that information shall be provided "in respect of activities covered by this licence".

- 4.956. Ofgem therefore proposes that the provisions of Special Condition 33 be placed, subject to the modifications above, in Special Condition E6 applicable to the relevant DN-GTs, and Special Condition C14 applicable to the NTS licensee and modifications. The revised drafting for these conditions is provided for comment in Appendices 8E & 8C respectively.
- 4.957. Ofgem invites respondents' views on its proposals for Special Condition 33. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition 34 – Licensee's methodology for determining incremental entry capacity volumes***

#### **Description**

- 4.958. This condition requires licensees to prepare and submit each year an audited incremental entry capacity release methodology statement setting out the methodology by which it will determine whether to make incremental entry capacity available for sale to shippers.

#### **Next Steps document**

- 4.959. In the next steps document Ofgem recognised the point raised by a shipper/supplier, relating to the potential for DN entry points but did not consider that it would be appropriate to amend Ofgem's proposals relating to this condition as there were no significant DN entry points at this time. Ofgem stated that this issue would be considered through the DISG.
- 4.960. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members, and as such, a number of DISG members included comments on this drafting in their formal responses.

## **Respondents' views**

### *NGT*

- 4.961. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.962. One potential purchaser agreed that this condition should not be applied to DNs and suggested its application should only be considered when it becomes evident that such entry points are planned.

### *Shippers/suppliers*

- 4.963. No shippers/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.964. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

## **Ofgem's proposals**

- 4.965. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to, the following:

- ◆ ensuring consistency with definitions applied, such that references are to "gas shippers" and "appropriate auditors";
- ◆ changes to cross-references; and

- ◆ modification to paragraph 2, such that the Authority approves the statement rather than just the form of that statement.

- 4.966. It should be noted that, it is anticipated that an equivalent condition for determination of incremental exit capacity volumes will be introduced as part of a further section 23 process subsequent to hive-down.
- 4.967. Ofgem therefore proposes that the provisions of Special Condition 34 be placed, subject to the modifications above, in Special Condition C15 applicable to the NTS. The revised drafting for this condition is provided for comment in Appendix 8C.
- 4.968. Ofgem invites respondents' views on its proposals for Special Condition 34. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 35 – NTS performance reporting***

### **Description**

- 4.969. This special condition provides for the collection of information by the licensee to an appropriate degree of accuracy, to monitor the environmental performance of the NTS and facilitate the development of an expenditure monitoring framework.

### **Next Steps document**

- 4.970. In the next steps document Ofgem stated that it remained of the view that this condition should be retained as a special condition in the licence of the NTS operator only (Special Condition C16).
- 4.971. Prior to submission of formal responses to the next steps document, draft price control conditions were presented to DISG members, and as such, a number of DISG members included comments on this drafting in their formal responses.

## **Respondents' views**

### *NGT*

- 4.972. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

### *Potential Purchasers*

- 4.973. One potential purchaser agreed that this condition should not be applied to DNs.

### *Shippers/suppliers*

- 4.974. One shipper/supplier suggested that further changes will be needed to this condition to reflect the exit reform proposals. This shipper/supplier suggested that it does not yet appear clear how transportation charges will be billed in respect of NTS directly connected sites, but, if the NTS bills these charges directly to shippers (as opposed to via the DNs), a number of elements of Standard Special Condition D9 (specified information) in respect of shipper queries etc should be replicated under this condition. In addition, this shipper/supplier considered that it would be useful for the NTS to report throughput volumes and billed/unbilled energy figures, including amounts billed to DNs and NTS direct connects in aggregate.

### *DISG comments*

- 4.975. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

## **Ofgem's proposals**

- 4.976. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting within Transco's current licences following the most recent section 23 modifications, which include, but are not limited to:

- ◆ changes to cross-references;
- ◆ deletion of the definition of “NTS” which is included in Standard Special Condition A3;
- ◆ modification of paragraph 1 to remove references to “expenditure monitoring framework”;
- ◆ insertion of the words “in the form and manner specified in the regulatory instructions and guidance” in sub-paragraphs (a) and (c) of the definition of “specified information”; and
- ◆ deletion of the existing paragraphs 9, 10 and 11 and replacement with new paragraphs 9 to 13 to clarify the steps associated with modification of the regulatory instructions and guidance, consistent with amendments to Standard Special Condition D9 in this regard.

4.977. Ofgem therefore proposes that the provisions of Special Condition 35 be placed, subject to the modifications above, in Special Condition C16 applicable to the NTS. The revised drafting for this condition is provided for comment in Appendix 8C.

4.978. Ofgem invites respondents’ views on its proposals for Special Condition 35. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 36 – LDZ incentive scheme and performance reporting***

### **Description**

4.979. This condition defines the incentive and performance measures applicable to Transco’s LDZ network.



## **Next Steps document**

- 4.980. In the next steps document Ofgem was of the opinion that this condition should be retained as a standard special condition in DN licences. Ofgem set out that since the publication of the September document, it had discussed at DISG the proposal to extend the provisions of this condition to oblige DN-GTs to conduct customer satisfaction surveys. Ofgem stated that NGT currently undertakes such surveys as part of its internal processes and that placing this obligation on DN-GTs would allow for the formalisation of current practice and ensure its continued provision despite different ownership of some of the DNs.

## **Respondents' views**

### *NGT*

- 4.981. NGT has stated that it is content with this condition and is inputting into the revision of the Regulatory Instructions and Guidance (RIGs), which is a subsidiary document to this licence condition, to incorporate the new requirement.

### *Potential Purchasers*

- 4.982. One potential purchaser commented on this issue explicitly, stating that it was happy to accept this obligation and therefore accepted the application and the drafting of Standard Special Condition D9.
- 4.983. One other potential purchaser welcomed Ofgem's decision not to introduce financial incentives associated with this licence condition before the next price control review. Further, this respondent also suggested that it would be more efficient and would ensure a consistent approach if Ofgem (or Ofgem's appointed agent) carried out the survey rather than each licensee appointing an approved independent third party. This respondent also suggested that the title should reflect that it is a standard special condition.

### *Shippers/suppliers*

- 4.984. As noted in chapter 3, three shippers/suppliers responded to this issue. Two outlined their support for this obligation with one of these respondents recommending that the obligations within the condition be worded to ensure

consistency in reporting methods adopted by the DN-GTs to facilitate comparisons. The other respondent questioned how compliance would be ensured given that there are no financial incentives associated with the customer survey.

*DISG comments*

- 4.985. The licence condition has not been discussed at DISG as Ofgem is simply proposing to delete this condition following a potential DN sale.
- 4.986. NGT stated that it was inappropriate to include the provision of information relating to queries from gas shippers in the new DN licences (because they cannot comply), as it can only be provided on a national basis (because it cannot be disaggregated by DN).
- 4.987. NGT also stated that Paragraph 10 (e) is a new addition and neither provides the licensee with any protection if it is unable to supply the requested information nor does it give a timescale for compliance. NGT therefore considered it unreasonable and requested its removal.
- 4.988. NGT further stated that in reference to paragraph 12, previously modifications which could lead to expensive changes for Transco could only be made at a charging review date (see paragraph 10 of the existing Special Condition 36). However, as this protection had now been removed, it potentially exposes licensees to significant costs for which they would not receive any corresponding allowance. NGT have therefore requested for a provision equivalent to paragraph 10 of Special Condition 36 to be reinserted.
- 4.989. Further modifications have been made following further discussions with NGT and NGT is also inputting into the revision of the RIGs, which is a subsidiary document to this licence condition.
- 4.990. One potential purchaser asked if obligations apply to individual RDN networks. This purchaser also stated that although they would be happy to carry out a customer survey as NGT currently does, they did not believe that it was necessary at this stage to incorporate it as a licence obligation. They added that this licence condition is likely to be key at the next price control review and they therefore believe that it would be better to consider it at that time.

4.991. This potential purchaser also noted that paragraphs 10 – 12 do not reflect the most recent drafting of the equivalent distribution licence conditions. Another potential purchaser asked if there was a conflict between a quarterly survey and the need for a robust sample of numbers.

4.992. energywatch commented in DISG 26 that they approved of these proposals.

### **Ofgem's proposals**

4.993. Ofgem has considered the representations made in respect of this condition and notes that they are broadly supportive. Ofgem recognises the concern raised by one potential purchaser that it might be more efficient if the survey was conducted centrally by Ofgem. However, Ofgem is satisfied that the approach proposed will enable DNs to appoint market research consultants efficiently, and that the results will be robust and comparable across licensees given both that the terms of reference for appointing the consultants are required to be approved by the Authority and that the RIGs set out explicitly the questions to be asked and the form of the survey, which will ensure consistency across all DNs.

4.994. As such, Ofgem proposes that each DN-GT licensee should undertake the customer satisfaction surveys of those customers that have experienced planned and unplanned non-contractual interruptions to supply in accordance with Standard Special Condition D9 as drafted.

4.995. Following consideration of respondents' views, Ofgem has made a number of modifications to the drafting appended to the next steps document, which include, but are not limited to:

- ◆ changes to cross-references;
- ◆ modification of paragraph 1 to remove references to "expenditure monitoring framework";
- ◆ clarification of the definition of "Distribution Network peak demand";
- ◆ deletion of the definition for "formula year" as it is now included within Standard Special Condition A3;

- ◆ deletion of the definition of “M number database” as it is no longer required;
- ◆ changing the name of the term “approved independent third party” to “independent third party”;
- ◆ definition of information regarding shipper queries, and information regarding the M-number CD-ROM from the definition of “specified information”;
- ◆ inserting the number of questions into sub-paragraph (b) of the definition of “specified information”;
- ◆ changing the dates and cross-references within paragraphs 4 and 5; and
- ◆ deletion of the existing paragraphs 10, 11 and 12 and replacement with new paragraphs 10 to 14 to clarify the steps associated with modification of the regulatory instructions and guidance, consistent with amendments to Standard Special Condition C16 in this regard and to achieve alignment of the RIGs change mechanism with DNO RIGs change mechanism.

4.996. Ofgem proposes that the provisions of Special Condition 36 be placed, subject to the modifications above, in Standard Special Condition D9 applicable to all DN-GTs. The revised drafting for this condition is provided for comment in Appendix 8D.

4.997. Ofgem invites respondents’ views on its proposals for Special Condition 36. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 37 – Exit code statement***

### **Description**

- 4.998. This condition requires the annual preparation and submission of an exit code, which provides a description of the services provided and revenue received by the licensee's NTS activity and DN activity.

### **Next Steps document**

- 4.999. In the next steps document Ofgem stated that this condition sought to achieve clarity in the services and revenues shared between the NTS and DN activities and considered that it would be redundant given other changes to the licence. Ofgem therefore expected that this condition would be switched off when the sale process was completed. However, to allow for the possibility of future divergence in requirements for this condition, Ofgem proposed that it should be replaced with a standard special condition in the licences of all DN licensees and a Special Condition for the NTS licensee.

### **Respondents' views**

#### *NGT*

- 4.1000. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.1001. One potential purchaser considered that this condition is redundant as a result of other provisions arising from the sale process and therefore the condition should be removed.

#### *Shippers/suppliers*

- 4.1002. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.1003. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.1004. Ofgem continues to believe that the requirements of this condition will cease to be necessary once enduring NTS exit arrangements have been implemented, as there will be a transparent, external NTS-DN interface that will remove the need for publication of such a statement.
- 4.1005. In the licence drafting provided in Appendix 7B of the next steps document, a paragraph was inserted so that the obligation to provide such a statement would cease to have effect upon hive-down. Following further consideration, Ofgem is now of the view that, rather than have a paragraph that triggers the cessation of this obligation within the provisions of this licence condition, it would be more appropriate to remove this condition as part of the licence modification process that is used to introduce the enduring exit and incentive arrangements.
- 4.1006. As a result, Ofgem has removed this "trigger" paragraph from the drafting of this condition, but notes that the NTS special condition and DN standard special conditions relating to the Exit Code Statement will be removed / switched off at the same time as the enduring exit arrangements are introduced.
- 4.1007. Furthermore, the drafting of these conditions has been modified such that the definitions for the terms used in this condition are referenced to Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and NTS system operation activity) and Special Condition E2A (Revenue restriction definitions in respect of the Distribution Network) as appropriate.

4.1008. Ofgem therefore proposes that the provisions of Special Condition 37, subject to the modifications above, will be placed in a special condition applicable to the NTS and a standard special condition applicable to all DN GT licensees. The revised drafting for these conditions (Special Condition C17 and Standard Special Condition D7) is provided for comment in Appendices 8C and 8D respectively.

4.1009. Ofgem invites respondents' views on its proposals for Special Condition 37. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition 38 – Restriction on Use of Information deriving from the EnMo Business***

#### **Description**

4.1010. This licence condition required the licensee to procure an undertaking relating to the disclosure of confidential information to EnMo.

#### **Next Steps document**

4.1011. In the next steps document Ofgem stated that having considered respondents' views, it continued to believe that it would be appropriate to remove this licence condition.

#### **Respondents' views**

##### *NGT*

4.1012. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

##### *Potential Purchasers*

4.1013. One potential purchaser agreed that this condition should be removed.

### *Shippers/suppliers*

- 4.1014. No shipper/supplier provided a detailed response to this licence condition with their formal responses to the next steps document.

### *DISG comments*

- 4.1015. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.1016. Ofgem continues to believe that it is appropriate to remove this licence condition. The drafting for this condition is provided for comment in Appendix 8A.
- 4.1017. Ofgem invites respondents' views on its proposals for Special Condition 38. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition 39 – Charging of Gas Shippers – Domestic Infill Premises***

### **Description**

- 4.1018. This condition relates to the charges that a licensee may charge where the licensee has, on request, extended a gas main to specifically connect premises.

### **Next Steps document**



- 4.1019. In the next steps document Ofgem set out that this condition should apply to both NTS and DN-GT Licences as a standard special condition, as it would not vary across licensees.

### **Respondents' views**

#### *NGT*

- 4.1020. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential Purchasers*

- 4.1021. One potential purchaser accepted the applicability and the drafting of Standard Special Condition A47.
- 4.1022. Another potential purchaser suggested that the word "amended" be deleted from the first line of paragraph 1 of this condition.

#### *Shippers/suppliers*

- 4.1023. No shipper/supplier provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 4.1024. The licence condition drafting for this condition has been discussed at a number of DISG meetings since publication of the next steps document (DISG 30 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2 for information.

### **Ofgem's proposals**

- 4.1025. Ofgem agrees that the word "amended" should be deleted from the first line<sup>5</sup> of paragraph 1 of the condition. This represents the only change to this condition relative to the next steps document. Ofgem continues to believe that this condition is applicable to both the NTS and DN-GT licensees.

- 4.1026. Ofgem therefore proposes that the provisions of Special Condition 39 be placed in Standard Special Condition A47 applicable to all NTS and DN-GTs. The drafting for this condition is provided for comment in Appendix 8A.
- 4.1027. Ofgem invites respondents' views on its proposals for Special Condition 39. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Schedules to Transco's GT licences***

### **Description**

- 4.1028. There are a number of schedules to Transco's GT licence which set out, among other things, the output measures for the NTS price control, Transco's Authorised Area, and the circumstances in which the Authority may revoke Transco's GT licence.

### **Next Steps document**

- 4.1029. In the next steps document Ofgem detailed that its proposals with respect to each of the schedules were as follows:
- ◆ Schedule A – NTS output measures for the price control: this schedule may need to be revised subject to reform of the interruptions and exit capacity arrangements;
  - ◆ Schedule 1 – Specified Area: this schedule would remain unchanged with the specified area being the whole of Great Britain;
  - ◆ Schedule 2 – Revocation of Licence: this schedule would not require modification;
  - ◆ Schedule 3 – Transportation Services Area: this schedule would remain unchanged with the specified area being the whole of Great Britain.

### **Respondents' views**

- 4.1030. One potential purchaser agreed with the proposed future nature of the various schedules.

### **Ofgem's proposals**

- 4.1031. Ofgem continues to expect that Schedules 1, 2 & 3 will not require modification.
- 4.1032. As regards Schedule A within the NTS licence, however, Ofgem has introduced an additional table (Table A5) for flow flexibility within the current price control period.
- 4.1033. This table is currently blank, and will be populated in a future section 23 process subsequent to hive-down once uniform network code proposals become clearer in this area. The requirement for this table will also be outlined in a forthcoming consultation document on incentive schemes to support the interim offtake arrangements.
- 4.1034. Ofgem invites respondents' views on its proposals for the schedules. Ofgem notes that, following consideration of respondents' views, further modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## 5. New licence conditions

5.1. In the next steps document, Ofgem set out for informal consultation its proposals on the restructuring of Transco's six GT licences in the context of DN sales. In addition to the proposed modifications to the existing conditions in Transco's licences, Ofgem considered that it may be appropriate to introduce certain new licence conditions to protect the interests of customers in a divested industry structure. To facilitate this, Ofgem invited views on a number of proposed new NTS and DN-GT licence conditions that it considers are necessary to protect the interests of customers in the event that proposed DN sales proceeds. Ofgem has also invited views on the proposed new licence conditions (including, where appropriate, updated drafting of these new conditions from that published with the next steps document) through the DISG meetings. Such updated drafting has also been published on Ofgem's website.

5.2. Following consideration of respondents' views and further consideration of the key provisions required, Ofgem is proposing to introduce the following new licence conditions:

- ◆ Structure of licences:
  - ◆ the private CLM procedure (Standard Special Conditions A2, B2 and D2); and
  - ◆ the switch on/switch off of standard conditions and standard special conditions (Standard Special Conditions A1, B1 and D1);
- ◆ Standard Special Conditions applicable to NTS and DN-GTs:
  - ◆ Joint Office governance arrangements (Standard Special Condition A12);
  - ◆ Agency obligations (Standard Special Condition A15);
  - ◆ Independence of the independent market for balancing (Standard Special Condition A16);

- ◆ Requirement not to prejudice the systems of other GTs (Standard Special Condition A17);
- ◆ Price control review information (Standard Special Condition A40); and
- ◆ Enduring offtake arrangements(Standard Special Condition A55);
- ◆ NTS Special Conditions:
  - ◆ Treatment of LNG Storage (Special Condition C1);
  - ◆ NTS definition of supply of transportation services (Special Condition C1A);
  - ◆ Independent market for balancing (Special Condition C6);
  - ◆ Charging obligations (Special Condition C7);
  - ◆ Undertaking from the ultimate controller concerning non-discrimination between the NTS and the DN (Special Condition C19);
  - ◆ Separation of NTS and DN businesses (Special Condition C20); and
  - ◆ Appointment and duties of the business separation compliance officer (Special Condition C21);
- ◆ Standard Special Conditions applicable to all DN-GTs:
  - ◆ First line emergency response services to the NTS (Standard special Condition D6);
  - ◆ DN interruption reform (Standard special Condition D8);
  - ◆ Connections (Standard Special Condition D10); and
  - ◆ Charging obligations (Standard Special Condition D11);

- ◆ RDN Special Conditions:
  - ◆ Separation of NTS and DN businesses (Special Condition E10);  
and
- ◆ IDN Special Conditions
  - ◆ amendment to Credit Rating of the Licensee(Special Condition E11)

5.3. All of the proposed new licence conditions listed above, with the exception of the 'keep well' agreements were either consulted upon within the next steps document and/or have been tabled for discussion at meetings of the DISG since the next steps document was published. In drafting these conditions, Ofgem has considered the views of respondents expressed in their formal responses to the next steps document as well as comments made during or subsequent to DISG discussions.

5.4. This chapter provides:

- ◆ a brief description of each of the new licence conditions proposed;
- ◆ a high level overview of the proposed treatment for each new condition as set out in the next steps document (where applicable);
- ◆ a summary of the responses received in relation to each of the proposed new licence conditions; and
- ◆ a description of Ofgem's views and associated decisions regarding each of the proposed new licence conditions.

5.5. The details of new conditions discussed as part of the next steps document, but of which are no longer proposed, are discussed at the end of this chapter.

## **Structure of licences**

### ***Standard Special Condition A2, B2, D2: Private Collective Licence Modification procedure***

#### **Next steps document**

- 5.6. As set out in Chapter 3, in the next steps document, Ofgem proposed to introduce three new standard special conditions for the purposes of establishing the private CLM procedure which would apply in respect of standard special conditions that apply to NTS and DN-GTs, as well as standard special conditions that apply only to NTS-GTs and/or DN-GTs separately. Ofgem considered that this proposed licence structure (and associated CLM procedure) would safeguard the interests of customers, and further, that it would be robust to any future changes in industry structure.
- 5.7. Ofgem noted the concerns expressed by respondents to the September document with regard (in their view) to the potential legality of the private CLM procedure, but, after careful further analysis, continued to believe that this approach was appropriate<sup>45</sup>.
- 5.8. Ofgem proposed that the voting thresholds applied should be the same as those set out in the statutory CLM procedure. Ofgem recognised concerns expressed by respondents to the September document that these thresholds would have the effect of allowing two GTs individually to veto proposed changes. However, Ofgem explained that the private CLM procedure was being proposed to mitigate the effects of the wholesale changes to Transco's six licences based on the workings of the statutory CLM procedure and to ensure that the level of flexibility afforded by the statutory CLM procedure would not be negated as a result of any DN sales. As such, Ofgem considered that it would be important for the threshold criteria within the private CLM procedure to mirror those set out in the statutory CLM procedure. Ofgem noted that the statutory CLM

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<sup>45</sup> Having regard to its statutory duties, and, in particular, to ensure that the interests of customers are protected in a multi gas transporter environment. Further, Ofgem considers the proposals have been developed within the limitations of, and in a manner consistent with the current statutory framework.

procedure underwent substantial consultation before it was introduced and that the different effects on licence holders had been considered at this point.

- 5.9. Ofgem set out that it had considered the specific comments provided by respondents with respect to the drafting of this condition but that it was of the opinion that the drafting consulted upon was sufficiently clear, and would ensure consistency with the associated switch on/switch off conditions.
- 5.10. In the next steps document, Ofgem noted that it was made clear in the September document that its intention was, as far as practicable and appropriate, to largely replicate the statutory CLM procedure to safeguard customers interests. Ofgem detailed that, under the statutory CLM procedure, it would be able to introduce (and had already introduced) new standard conditions and to vary such conditions. In line with this, Ofgem stated that it was of the view that the private CLM procedure (which was intended largely to replicate the statutory CLM procedure) should also enable the introduction of new standard special conditions or the variance of existing conditions which could apply to NTS and DN-GTs or to NTS or DN-GTs separately.
- 5.11. Ofgem clarified that the procedure could not be used to introduce or modify special conditions applicable to individual GT licensees and that the drafting of the proposed condition was sufficiently clear on this point.

### **Respondents' views**

#### *NGT*

- 5.12. NGT did not comment on the private CLM within its formal response to the next steps document.

#### *Potential purchasers*

- 5.13. The high level views of potential purchasers on the private CLM are set out in Chapter 3. Overall one potential purchaser supported the introduction of the private CLM procedure and the proposal to base the voting thresholds on the statutory CLM procedure. CKI/UU and Macquarie were concerned that the proposals relating to the voting thresholds were discriminatory and raised the following points:



- ◆ Macquarie stated that a 10% threshold, by number of licensees, to block a proposed modification should be considered (instead of the 20% level proposed in line with the statutory CLM procedure);
- ◆ both Macquarie and CKI/UU noted that Transco and SSE could veto any proposals, and CKI/UU stated that therefore, as drafted, the private CLM procedure does not give Ofgem the ability to modify licences consistently in a divested industry structure;
- ◆ both Macquarie and CKI/UU stated that the proposal was inequitable/unduly discriminatory as it would enable licence modifications to be implemented without their consent;
- ◆ Macquarie noted that Ofgem had cited the fact that there had been substantial consultation on the statutory CLM procedure as support for its proposal to align the threshold criteria for the private CLM with the statutory CLM. However, Macquarie stated that the fact that substantial consultation had taken place regarding the statutory CLM procedure did not provide sufficient reason to maintain the status quo. Furthermore, Macquarie noted that the consultation on the statutory CLM procedure did not request views in relation to the detailed application of the CLM procedure in a disaggregated gas network world;
- ◆ CKI/UU stated that the number of parties affected by and the rationale behind the statutory CLM procedure was entirely different from the current situation; and
- ◆ CKI/UU also questioned whether, as the CLM procedure was not used due to the small number of licensees in electricity transmission, the implementation of a private CLM for a small number of NTS and DN-GTs was consistent with this approach.

5.14. In addition to the views of potential purchasers, the following comments were made on the detail of the drafting:

- ◆ the wording "relevant licence holder" should be amended to be more explicit;

- ◆ that further clarity maybe required in respect of the interactions between the switch on/switch off conditions (Standard Special Condition A1, B1 and D1) and the private CLM procedure. In particular, whether a new standard special licence condition would be introduced and “activated” by the private CLM process or whether the activation of that new condition would only be achieved by the issuing of a “direction” under the switch on/switch off condition; and
- ◆ that the drafting for “weighting according to market share” needed to be amended so that the total quantity of gas transported by those relevant license holders is divided by the total quantity of gas transported by all relevant licence holders.

#### *Shippers/suppliers*

- 5.15. The views of shippers/suppliers are set out in Chapter 3. Overall, the shippers/suppliers who responded on this issue were opposed to the introduction of the private CLM procedure and questioned the Authority’s vires to introduce this condition. One respondent raised similar concerns regarding the effects of the proposed voting thresholds as that raised by the potential purchasers. Shippers/suppliers offered no comments on the detail of the conditions.

#### *DISG comments*

- 5.16. As set out in Chapter 3 the proposed licence conditions to implement the private CLM procedure have been discussed and refined at a number of DISG meetings since the publication of the next steps document (DISG 29, DISG 31 and DISG 34). Industry participants and other interested parties have therefore provided detailed comments on this drafting both during these meetings and by written responses subsequent to these meetings. The minutes of these meetings are attached in Appendix 2.
- 5.17. The proposed changes to the private CLM procedure licence conditions put forward at DISG included a change to the definition of the “relevant licence holder” which seeks to clarify that a relevant GT whose licence would not be modified in the event that a proposed modification was introduced pursuant to a private CLM procedure would not be able to vote on that modification.

However, if the modification was made under the private CLM procedure and the condition was subsequently switched back on that licence, the licensee would need to comply with the condition as modified.

5.18. The following section highlights new points that were raised through the DISG meetings:

- ◆ a potential purchaser queried the basis of the proposed change to the definition of “relevant licence holder” put forward by Ofgem (as set out above). This purchaser was concerned that the revision suggested that Ofgem intended the private CLM procedure to be used to modify the licences of some transporters who have the standard special conditions but not others. The potential purchaser did not consider this appropriate as the purpose of the private CLM procedure is to modify all relevant licences and not those of a subset of GTs; and
- ◆ NGT suggested that the new wording put forward by Ofgem regarding the definition of “relevant licence holder” could be simplified.

### **Ofgem’s proposals**

5.19. As stated in Chapter 3, Ofgem continues to believe that it is necessary to introduce the private CLM procedure pursuant to section 7B(7)(b) of the Gas Act to address the specific issues that have arisen as a consequence of NGT’s planned DN sales and therefore to protect the interests of customers. This section of the Gas Act enables the Authority to introduce a private CLM procedure through provisions specifying the manner in which the licence conditions are to be modified. While Ofgem notes the concerns raised by the Gas Forum and other shippers/suppliers, Ofgem, having carefully considered respondents views, remains of the view that the Authority has vires under the Gas Act both to grant licences and also to amend such licences in this manner.

5.20. Ofgem has considered the issue of threshold requirements as set in Chapter 3. Ofgem has given consideration to the points raised by Macquarie, CKI/UU and one shipper/supplier regarding the potential adverse effects of this position and the proposal to change the threshold requirements to 10% rather than 20%. However, Ofgem continues to consider that it would be inappropriate to change the threshold requirements from those set out in the statutory CLM procedure.

The thresholds that were put in place for the statutory CLM procedure were the subject of consultation, although Ofgem agrees with the respondent who stated that a divested gas industry was not considered as part of these proposals. For the avoidance of doubt the private CLM procedure is not being introduced to address potential shortcomings in the workings of the threshold requirements of the statutory CLM procedure. Ofgem therefore, considers that it is inappropriate to seek to address issues relating to the statutory CLM procedure as part of DN sales. If the DTI were to consult upon, and ultimately change, the statutory CLM procedure, Ofgem would consult upon corresponding changes to the private CLM procedure.

- 5.21. Ofgem continues to consider it appropriate to align the threshold requirements for voting within the private CLM procedure with the statutory CLM procedure and do not consider these arrangements to be unduly discriminatory.
- 5.22. Since the publication of the next steps document, and following consideration of drafting comments made by respondents, Ofgem has made a number of modifications to the drafting to improve the clarity of the private CLM conditions, including, but not limited to the following:
- ◆ the definitions have been moved to the front of the condition;
  - ◆ it has been clarified throughout that each of Standard Special Condition A2, Standard Special Condition B2, and Standard Special Condition D2 relate to Standard Special Conditions in Parts A, B and D of the licence respectively;
  - ◆ it has been clarified that references to sections A and B are to the relevant sections of the standard conditions;
  - ◆ the definition of “private collective licence modification procedure” has been shortened and clarified;
  - ◆ the definitions of “relevant notice” and “weighted according to market share” have also been clarified; and
  - ◆ other minor changes to correct typographical and grammatical errors

- 5.23. Ofgem accepts the comments raised by NGT and the potential purchaser that the changes Ofgem proposed at DISG relating to the definition of a “relevant licence holder” (which sought to clarify that GTs whose licences were not being modified pursuant to a modification being introduced via the private CLM procedure did not have a vote in respect of such a modification) were inappropriate and confusing. This paragraph has now been deleted from the text.
- 5.24. Generally, it is worth noting that where a standard special condition is switched off in the licence of a particular GT and a proposed modification is put forward pursuant to the private CLM procedure in respect of that licence condition, and it is not proposed that the licence condition will be switched on in the licence of that particular GT following the implementation of any such modification, the GT in question will not be entitled to vote on the implementation of such a modification under the terms of the private CLM. This follows the rules in the statutory CLM procedure. However, if the condition was to be switched back on, it would incorporate the amendment, again consistent with the statutory CLM procedure. If a new licence condition would be proposed, the relevant licence holder would be all licensees in that category even if the condition would not be switched on in any particular licence.
- 5.25. The modified drafting for Standard Special Conditions A2, B2 and D2 conditions is provided for comment in Appendices 8A, 8B and 8D respectively.
- 5.26. Ofgem invites respondents’ views on its proposals for Standard Special Conditions A2, B2, and D2. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition(s) A1, B1, D1: Application / Disapplication of standard conditions and standard special conditions***

### **Next steps document**

- 5.27. In order to ensure that the private CLM procedure would operate as intended, Ofgem proposed to restructure Transco's licence such that:
- ◆ the amended standard conditions in Transco's six licences, and certain special conditions, would revert to the terms of the standard conditions as designated by the Secretary of State as modified by the statutory CLM, while some may become standardised special conditions;
  - ◆ where a modification to a standard condition is required as a result of DN sales, the relevant standard condition will be replicated as a standard special condition (incorporating the necessary modifications) which could be subject to the private CLM procedure;
  - ◆ a switch on/switch off<sup>46</sup> condition is introduced to apply to standard conditions in part A and B of the standard conditions to ensure that the licensee is not subject to two similar conditions; and
  - ◆ a switch on/switch off condition is introduced to apply to standard special conditions in the licences of NTS and DN-GTs.
- 5.28. In order to achieve this, Ofgem proposed to implement three new standard special conditions to introduce a switch on/switch off mechanism for:
- ◆ standard conditions within sections A and B of the standard conditions within the GT licences (Part C would be covered by the existing switch off/switch on mechanism set out in Standard Condition 2 of the GT licence);

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<sup>46</sup> This switch allows conditions to be switched on or off as a whole or in part and permits, for the avoidance of doubt, entire sections to be switched off or on.

- ◆ standard special conditions applicable to NTS and DN-GT licensees (Part A of the proposed standard special and special conditions);
- ◆ standard special conditions applicable to NTS licensees (Part B of the proposed standard special and special conditions); and
- ◆ standard special conditions applicable to DN licensees (Part D of the proposed standard special and special conditions).

5.29. Ofgem indicated that the drafting of these proposed conditions provided that the Authority may, with the consent of the licensee:

- ◆ issue a direction to switch on and/or switch off (in whole or in part) standard special conditions and/or switch off (in whole or in part) standard conditions in sections A and B of the standard conditions; and
- ◆ switch standard special conditions and standard conditions that have been switched off back on.

5.30. Ofgem also set out its proposals that there would be no time or frequency limit on the use of the switch.

### **Respondents' views**

#### *NGT*

5.31. NGT did not raise any issues concerning this licence in its formal response to the next steps document.

#### *Potential purchasers*

5.32. The high level issues raised by potential purchasers with respect to the switch on/switch off mechanism proposed are summarised in Chapter 3. Overall, one purchaser supported the drafting, and one purchaser raised comments regarding the interactions between these conditions and the private CLM licence conditions (Standard Special Condition A2, B2 and D2). In particular, this purchaser pointed out that as drafted, any licence conditions introduced pursuant to the private CLM procedure would not be effective until they were switched on under the relevant switch condition. The operation of the switch

would then require the consent of the licensee which would negate the effectiveness of the private CLM procedure.

5.33. In addition to these views potential purchasers, made the following comments on the detail of the drafting:

- ◆ one potential purchaser accepted the applicability and the drafting of Standard Special Condition A1, Standard Special Condition B1 and Standard Special Condition D1; and
- ◆ another potential purchaser supported the introduction of the “switch on/off” standard special licence conditions and the drafting of this condition to the extent that it does not incorporate explicit links between the switching off and on of standard and standard special licence conditions. This potential purchaser was unsure that the proposed drafting achieved the intent in respect of the activation of standard special licence conditions.

#### *Shippers/suppliers*

5.34. High level issues raised by shippers/suppliers with respect to the switch on/off mechanism proposed are summarised in Chapter 3. One shipper/supplier pointed out that as drafted, the licence conditions required the Authority to issue a direction under paragraph 2 of this condition, which would, itself, not be in effect until the direction was issued. The respondent considered that in order for the Authority to issue a direction, paragraph 2 of the condition would need to be in effect before the direction was issued.

#### *DISG comments*

5.35. As set out in Chapter 3 the licence condition drafting for the switch on/switch off provisions has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 31 and DISG 34). Industry participants have therefore provided detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

5.36. The point raised by the potential purchaser above, that the requirement for the consent of the licensee to operate the switch could impact on the workings of



the private CLM procedure was discussed at DISG. Ofgem proposed two new versions of the switch on/switch off conditions at subsequent DISG meetings.

- 5.37. In the first version of this condition, presented to DISG 31, the requirement for the licensee's consent to operate the switch had been removed.
- 5.38. In the second version of this condition, presented to DISG 34, the requirement for the licensee's consent was reinstated with the exception of circumstances where the switch was being used pursuant to a licence modification required as a result of the operation of the private CLM procedure.
- 5.39. Serious concerns were raised at the DISG meetings and in written responses in relation to the first of these versions in which the requirement for the consent of the licensee in respect of the operation of the switch was removed. In particular:
- ◆ one potential purchaser considered that if the consent requirement was removed, there was a need to put in place objectives that would govern the use of the condition;
  - ◆ another potential purchaser stated that as Ofgem is attempting to largely replicate the provisions of the equivalent statutory standard licence conditions and the statutory collective licence modification process, it found the drafting presented unacceptable;
  - ◆ this respondent also stated that the removal of the 'consent' had the potential to drive directly the value of a licensee's activities. This respondent explained that, with the removal of the licensee's 'consent', conditions could be switched on and off more onerously which could have a significant impact on the operation and value of a licensee's business; and
  - ◆ this respondent also stated that whilst it understood Ofgem's concerns that this licence condition could compromise the private CLM procedure, the potential purchaser believed that these concerns are unfounded. The potential purchaser stated that the licensee's 'consent' does not challenge the integrity of the private CLM procedure. The potential purchaser stated that inserting other provisions within this

licence condition can give protection against this condition affecting the integrity of the private CLM procedure.

- 5.40. DISG respondents were generally more supportive of the second version of the licence condition described above and considered it to be a more reasonable and proportionate proposal. DISG members considered that this version of the licence condition balanced the interests of customers with the rights of the licensee, although one potential purchaser was concerned that the condition enabled Ofgem to use the switch to introduce “consequential amendments” resulting from the operation of the private CLM procedure without the licensee’s consent and considered that this power was too widely drafted.
- 5.41. DISG participants also raised additional points on the proposed drafting of the switch licence conditions:
- ◆ a potential purchaser noted that paragraph 3 of the proposed conditions needed further clarification to set out clearly the situations in which the switch can be used; and
  - ◆ In relation to paragraph 6(a) of this condition a potential purchaser stated that it did not understand why the word “elsewhere” had been included.

### **Ofgem’s proposals**

- 5.42. As stated in Chapter 3, following consideration of respondents’ views, Ofgem has revised the drafting of Standard Special Condition A1, Standard Special Condition B1, and Standard Special Condition D1 relative to the versions consulted upon within the next steps document such that the licensee’s consent is still required, but that the consent is not required where consequential changes are being made as a result of the private CLM process.
- 5.43. Following further consideration by Ofgem, paragraph 8, as well as paragraphs 1 to 4 of Standard Special Condition A1, Standard Special Condition B1, and Standard Special Condition D1 will be operative in the licences of **all** NTS and DN-GTs in order to allow the switch mechanism to operate and, as such, paragraphs 1 to 4 and paragraph 8 themselves cannot be switched off.
- 5.44. Since the publication of the next steps document, Ofgem has made a number of further modifications to the drafting to improve the clarity of the switch

on/switch off conditions, including, but not limited to the following clarifications:

- ◆ in paragraph 1, that the switch on/switch off mechanism does not apply to paragraphs 1 to 4 and paragraph 8 of the switch on/switch off conditions, or new conditions introduced by means of the private CLM process, the Gas Act or the Energy Act;
- ◆ that each of Standard Special Condition A1, Standard Special Condition B1, and Standard Special Condition D1 relate to Standard Special Conditions in Parts A, B and D of the licence respectively;
- ◆ that references to sections A and B are to the relevant sections of the standard conditions;
- ◆ that entire Parts of the licence (with the exception of paragraphs 1 to 4 and paragraph 8 of the switch on/switch off conditions) can be switched on or off; and
- ◆ that the provisions of paragraph 8 should only apply to the extent to which this is appropriate.

5.45. In response to the issues raised by DISG members, Ofgem has the following comments:

- ◆ Ofgem has considered the point raised by a potential purchaser regarding the use of the switch in respect of amendments which are consequential to a modification introduced by the private CLM procedure.<sup>47</sup> However, Ofgem considers that such a provision would be necessary in certain situations. For example, where a modification is required to a standard condition as designated by the Secretary of State, it may be put forward by way of the introduction of a standard special condition containing the provisions of the standard condition and the necessary modifications. If this new condition is introduced through the private CLM procedure, Ofgem would then need to be able to switch off

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<sup>47</sup> In this regard, Ofgem would note that the statutory CLM procedure does allow consequential variances to be made, and as such its proposals are consistent with this.

the standard condition within the licences of the GTs to which the new standard special condition is being introduced. In the future, a failure to be able to effect this switch may frustrate the benefits to customers which arise from the introduction of the new standard special condition;

- ◆ in relation to the comment raised by a potential purchaser, in relation to why the word “elsewhere” had been inserted, Ofgem has used the wording which is presently used in Standard Condition 2 of Transco’s existing GT licences; and
- ◆ paragraph 3 of the proposed draft has been clarified and now states that entire parts of the licence can be switched on or off.

5.46. Ofgem invites respondents’ views on its proposals for Standard Special Conditions A1, B1 and D1. The modified drafting for these conditions is provided for comment in Appendices 8A, 8B and 8D respectively.

5.47. Ofgem invites respondents’ views on its proposals for Standard Special Conditions A1, B2, and D1. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## **Standard Special Conditions applicable to all NTS and DN-GTs**

### **Standard Special Condition A12: Joint Office Governance Arrangements**

#### **Next steps document**

5.48. The Authority's Agency and Governance Arrangements decision document<sup>48</sup> sets out Ofgem's view that, in the event that the proposed sale proceeds, a governance entity should be established in order to administer:

- ◆ the UNC modification process; and
- ◆ the process for introducing changes to network charging methodologies.

5.49. In the next steps document, Ofgem stated that to facilitate this, a new licence condition would be introduced into the licence of all NTS and DN-GTs and would require the licensee to establish, operate and develop arrangements for:

- ◆ the administration of the Network Code modification procedures;
- ◆ the administration of the coordination<sup>49</sup> of the modification of the licensee's and other relevant gas transporters' respective charges, reserve prices or charging methodologies;
- ◆ the administration of common systems arrangements;
- ◆ the administration of such matters as are provided for in the UNC; and
- ◆ the provision of efficiency in the implementation and administration of the Network Code.

5.50. Ofgem set out that the licensee would also be required to enter into a Joint Office Governance Arrangements Agreement (JGA) providing for the

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<sup>48</sup> *National Grid Transco Potential sale of gas distribution network business – Agency and Governance Arrangements decision document* - Ofgem Decision document 120/04

<sup>49</sup> Coordination of the administration of charge changes.

establishment and operation of the Joint Office and detailed that the JGA should (in summary and without limitation):

- ◆ ensure compliance with network code modification procedures;
- ◆ promote efficiency in the administration of the Network Code modification procedures so far as is consistent with the objective above; and
- ◆ avoid undue discrimination or preference as between the relevant gas transporters.

5.51. Ofgem considered that NGT's proposal to develop a JGA, which all NTS and DN-GTs would be required to be party to, would be an appropriate vehicle for establishing the governance entity.<sup>50</sup> Ofgem stated that, among other things, the governance entity's governance arrangements should exercise its functions impartially. Ofgem clarified that the Joint Office would be funded by subscription fees in line with current NTS and DN price controls but that NGT had yet to provide a copy of the proposed agreement between the GTs.

5.52. Ofgem outlined that a further feature of the proposed governance arrangements would be that the Joint Office would be required to exercise its functions independently and without undue regard to the interests of any particular party. Consequently, Ofgem considered that the Joint Office should be subject to structural separation from the GT licensees and that this should include information separation, separate staff and separate offices (or offices with separate security access).

### **Respondents' views**

5.53. Respondents' views to Ofgem's proposals to introduce a Joint Office are discussed at a high level in Chapter 3. Overall, respondents' views in relation to Standard Special Condition A12 (Joint Office Governance Arrangements) are summarised below:

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<sup>50</sup> NGT's proposals are set in its paper on the constitution and structure of the GT Joint Office, DISG 17.

- ◆ NGT and two potential purchasers supported the proposed role of the Joint Office to administer changes to transportation charges and charging methodologies for the NTS and DN-GTs.
- ◆ Several shippers/suppliers were however concerned that the emergence of different and diverging DN charging methodologies would have a significant impact on systems, billing and customer costs, and supported the inclusion of a licence condition that would subject all DNs to national charging methodologies that would be managed by the Joint Office.

5.54. In addition to these high level views a number of respondents commented on the detail of the proposals. There views are set out in turn below.

#### *NGT*

5.55. As noted in Chapter 3, NGT supported the proposed role of the Joint Office to administer changes to transportation charges and charging methodologies. However, NGT considered that the administration of common systems arrangements was outside the scope of the Joint Office's role, and therefore suggested that this requirement was deleted. NGT suggested that if the Joint Office were to have a role in the administration of common systems arrangements (in addition to the Network Operator Representative and xoserve), it would not require a licence condition.

#### *Potential purchasers*

5.56. One potential purchaser agreed with Ofgem's proposal that the Joint Office was an appropriate means of delivering the services specified. This potential purchaser accepted the need to separate the Joint Office from all NTS and DN-GTs. This potential purchaser further considered that it would be appropriate to do this through legal licence drafting but suggested that a cost effective solution would be for the Joint Office to be aligned with the Agency, at least in terms of Joint Office and administrative arrangements, with an operational charter that emphasised its independence. This potential purchaser noted that the drafting of the JGA was still outstanding and queried whether these documents should be subject to widespread consultation and discussion. This potential purchaser

stated that subject to viewing these documents it accepted the licence drafting provided.

- 5.57. Another potential purchaser suggested that the JGS should purely relate to the administration process that is associated with the modification of gas transportation charges, reserve prices or charging methodologies and was unsure whether it was appropriate that the Joint Office would be involved in the administration of common systems arrangements.
- 5.58. Another respondent suggested that the condition is too widely drawn and the Joint Office should only cover those matters specifically provided to be dealt with by the Joint Office in the UNC.

#### *Shippers/suppliers*

- 5.59. In general, shippers/suppliers were in favour of the proposals. One respondent suggested that while it is understood that the JGA will be between the NTS and DN-GTs, where an amendment is proposed and submitted to the Authority it would be reasonable to include a provision for users of the Joint Office to be consulted prior to such changes with the responses to the consultation included in the submission to the Authority.
- 5.60. Another respondent questioned whether the Joint Office, run at arm's length from the transporters, would be sufficiently independent from NTS and DN-GTs. This respondent stated that it believed it would be worthwhile establishing a more constitutionally separate Joint Office.

#### *DISG comments*

- 5.61. As discussed in Chapter 3 the licence condition drafting for Standard Special Condition A12 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Industry participants have therefore provided detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.
- 5.62. The draft of Standard Special Condition A12 presented at DISG 33 differed from the next steps document drafting with respect that an additional paragraph had been inserted (from Standard Special Condition A11) which allowed the licensee



to procure compliance with a number of its obligations in Standard Special Condition A11, by means of the Joint Office, to avoid duplication of information.

5.63. DISG members provided a number of comments. These included:

- ◆ one potential purchaser raised a comment in relation to the JGA and asked whether Ofgem would be designating this agreement; and
- ◆ one potential purchaser stated that it welcomed the insertion of the paragraph at DISG 33, but stated that its support for this condition was still conditional on satisfactory development of the JGA.

### **Ofgem's proposals**

5.64. As stated in Chapter 3, Ofgem continues to consider the Joint Office an important element in protecting the interests of customers in a divested industry structure. Ofgem therefore continues to propose that the Joint Office should have responsibility for:

- ◆ the administration of the Network Code modification procedures;
- ◆ the administration of the co-ordination of the modification of the licensee's and other relevant gas transporters' respective charges, reserve prices or charging methodologies;
- ◆ the administration of common services and system arrangements (through the Agency);
- ◆ the administration of such matters as are provided for in the UNC; and
- ◆ the provision of efficiency in the implementation and administration of the Network Code.

5.65. Ofgem has carefully considered the issue raised by a respondent as to whether the Authority should designate the JGA. Ofgem believes that this is an issue for the parties to this agreement to develop between themselves so that it is consistent with licensees statutory and licence obligations and therefore, consistent with the Authority decision, as such it has decided that it would not be appropriate to designate this document. In addition it is for GTs to ensure the financial arrangements for the Joint Office between themselves, given their

licence arrangements. However, given the interest of other market participants, Ofgem will invite interested parties views in the JGA through the DISG. Ofgem considers it important that NGT prepares the JGA as soon as possible following publication of this document to enable other participants to comment on the licence drafting and for Ofgem following consideration of respondents views to determine whether any additional licence drafting is required relating to this issue.

- 5.66. In respect of changes to the JGA, the proposed licence condition requires the licensee to submit any proposed amendment to the JGA to the Authority and the Authority has the right to veto any such changes. Ofgem would expect that, in considering whether to exercise its right of veto, it would be appropriate to consult with interested parties (including, without limitation, shippers/suppliers) on the proposed change to the JGA. The GTs will then be required by the licence condition to publish the JGA as modified from time to time.
- 5.67. In relation to comments raised by shipper/suppliers concerning whether the Joint Office would be run at 'arm's length,' Ofgem does not consider that it is appropriate to require the Joint Office to be independent from the GTs by way of a licence condition at this stage. However, Ofgem does consider that impartiality of the Joint Office is important given its role in respect of the administration of modification proposals. As such, Ofgem expects the JGA to include provisions relating to impartiality. As set out above, Ofgem is expecting NGT to issue the JGA in the near future, and is keen that shippers/suppliers consider the requirements in the Agreement relating to the impartiality of the Joint Office and submit views on this issue to Ofgem. As Ofgem has set out previously, the issue of funding and the independence of the Joint Office could be considered further at the next price control review.
- 5.68. In addition, it should be noted that the draft condition requires that the JGA shall avoid undue discrimination or preference between the relevant gas transporters. This is in addition to the NTS and DN-GTs overall obligations with respect to no undue discrimination.
- 5.69. Ofgem has, since the publication of the next steps document, made a number of further modifications to the drafting to improve the clarity of Standard Special Condition A12, including, but not limited to, the following modifications:

- ◆ the insertion (and subsequent modification / clarification) of paragraph 17 from A11 as presented at DISG 33 to clarify that certain obligations of Standard Special Condition A11 can be met through the Joint Office;
- ◆ general clarification throughout the condition that the obligations within it can also be met jointly;
- ◆ deletion of the reference to the Common Systems Agreement and Standard Special Condition A14 in paragraph 1, but the insertion of a reference to Standard Special Condition A15 (Agency);
- ◆ clarification of network code definitions generally, and modification of paragraph 1 to require efficiency in the implementation and administration of the UNC and/or network code; and
- ◆ insertion of a requirement for the licensee to have entered into the JGA by the date upon which the licence condition takes effect (unless the Authority otherwise consents in writing).

5.70. As stated above, Ofgem will be consulting with interested parties on their views on the JGA, through DISG. Ofgem invites respondents' views on its proposals for Standard Special Condition A12. The modified drafting for this condition is provided for comment in Appendix 8A.

5.71. Ofgem invites respondents' views on its proposals for Standard Special Condition A12. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition A15: Agency***

### **Next steps document**

5.72. In the next steps document, Ofgem proposed to introduce a new licence condition setting out requirements relating to the Agency. Ofgem acknowledged that if the proposed agency arrangements were to fragment as a result of NTS or DN-GTs opting out of the agency arrangements, there would be significant cost implications for shippers/suppliers and ultimately customers. As such, Ofgem proposed to introduce a new licence condition on the NTS and DN-GTs which would oblige them to operate through the Agency and stated that the scope of the Agency would be defined within the UNC. Ofgem stated that the proposed drafting of this condition included (without limitation) the following provisions requiring:

- ◆ the economic and efficient operation of the Agency;
- ◆ activity based costing of the Agency; and
- ◆ the transparent allocation of costs amongst relevant NTS and DN-GTs.

### **Respondents' views**

5.73. The UNC arrangements, including the Agency requirements are discussed in Chapter 3. Respondents' views in relation to Standard Special Condition A15 (Agency) are summarised in the following below:

- ◆ While NGT initially considered that the scope of the Agency and subcontracted services should not be included in the UNC, it has reversed its position in recent DISG discussions. NGT has also supported the concept of commercial rules that relate to the offtake of gas at all NTS exit points residing in the UNC.
- ◆ Potential purchasers and shippers/suppliers were generally in support of Ofgem's UNC related proposals; and
- ◆ Shippers/suppliers overall supported Ofgem's proposals.

- 5.74. A number of respondents have however, over the course of the consultation, expressed confusion regarding the interaction between the Common System Obligation licence condition and the Agency licence condition. Following further consideration, Ofgem has decided that the Common System obligation and Agency obligation should be merged into a single licence condition.
- 5.75. Following consideration of respondents' views, Ofgem has therefore merged the provisions previously contained within the Common System Obligation condition (previously Standard Special Condition A14) with those of Standard Special Condition A15 and as such, respondents' views on Standard Special Condition A14 (Common System Obligation) are also summarised below.

*NGT*

- 5.76. In addition to the comments in Chapter 3, NGT stated that it did not consider that activity based costing was appropriate in respect of agency costs. NGT considered that a requirement for the transparent allocation of costs amongst NTS and DN-GTs was sufficient and that the references to activity cost basis should be removed.
- 5.77. Furthermore, as stated in Chapter 3, NGT stated that the modifiable UNC was not the appropriate place to define the scope of obligations a party must sub-contract to a service provider or the definition of such sub-contracting arrangements.
- 5.78. NGT further highlighted that there were no specific requirements in the drafting within the next steps document that prevented GTs from opting out of the Agency.
- 5.79. With respect to the Common System Obligation condition, NGT agreed that system cost allocation needs to be robust and transparent but did not consider that an activity based cost system would support the requirements of the drafting within the next steps document. NGT further suggested that the wider publication of the CSA is not necessary and may contain confidential information.

### *Potential purchasers*

- 5.80. Overall, the potential purchasers supported the concept of the Agency as an appropriate means of avoiding fragmentation.
- 5.81. One potential purchaser stated that it may also be necessary to consider alternative solutions if they were cost-effective and did not lead to fragmentation.
- 5.82. Another potential purchaser supported the introduction of an Agency licence condition but stated that it did not believe that the draft Agency licence condition achieved the policy intended, as it did not prevent GTs from opting out of the Agency agreement. This respondent suggested that the agency condition should require the relevant GTs to establish and be party to the Agency and that the scope of that Agency should be set out in the Agency Services Agreement (ASA) which could not be modified without Ofgem's consent.
- 5.83. In relation to the common systems obligations, one potential purchaser supported the concept of common systems but noted the outstanding drafting of the CSA and the CSA Agreement. Another potential purchaser requested clarification on the interaction of this obligation with that associated with the proposed agency arrangements which also seems to provide for "agreed common systems and procedures". Another respondent also suggested that, in relation to the common systems obligation, it should be made clear that the DN's obligations relate only to the systems that are required for operation of the DN and do not place an obligation on the DN in relation to systems used to operate the NTS.
- 5.84. One potential purchaser was also unsure whether it will be possible to comply with the activity based costing requirements outlined in this condition within the timescales available before the next price control review.
- 5.85. Another respondent stated that clarification was needed in relation to the licensee's right to procure and provide services on a common basis. This respondent asked whether Standard Special Condition A15 would mean that the same services are being provided, or similar services are being provided in the same way or services are being provided using the same systems.

### *Shippers/suppliers*

- 5.86. In addition to the comments set out in Chapter 3, one respondent considered that the obligation in Standard Special Condition A15 should be for the licensee to always provide common services via a common service provider. This shipper/supplier suggested that, in the event that this is not the case, common data formats would be critical to ensuring shippers do not have to adapt their systems if a particular DN chose to discharge their obligations directly, and not through the Agency. This respondent also suggested, in relation to the common systems obligation, that reference should be made to data formats, as well as "systems and processes", as these are equally critical to the prevention of fragmentation. This shipper/supplier also suggested that shippers/suppliers would need to be able to comment on the adequacy of the "Statement of Common Systems" in advance of it taking effect.
- 5.87. Another shipper/supplier suggested that the drafting of Standard Special Condition A14 presented in the next steps document appeared only to apply to those systems which would be listed in the Statement of Common Systems delivered to the Authority on or before the effective date of the condition, as there were no procedures outlined for updating the Statement.

### *DISG comments*

- 5.88. As set out in Chapter 3, the licence condition drafting for Standard Special Condition A15 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Ofgem presented the new drafting for Standard Special Condition A15 at DISG 33 which included the provisions relating to Common System Obligations previously set out in Standard Special Condition 14. DISG participants were broadly supportive of Ofgem's proposal to merge these two conditions. The minutes of these meetings are attached in Appendix 2.
- 5.89. Industry participants have provided detailed comments on this drafting both during these meetings and by written responses after this meeting. Some of these detailed comments received are summarised below, and the minutes of these meetings are appended in Appendix 2.

- 5.90. As set out above and in Chapter 3, in more recent discussions in DISG, NGT has accepted the need for the scope of the services and systems that will be sub-contracted to the Agency to be set out within the UNC, thereby changing its view as expressed in an earlier formal response.
- 5.91. NGT has also repeated its concern that the drafting of the activity based costing provision within the draft of Standard Special Condition A15, as discussed at DISG 33, did not provide sufficient clarity regarding the level of detail of cost information that should be provided.
- 5.92. NGT has also expressed further concerns following DISG 34, regarding the publication of the Agency Services Agreement, expressing the view that only the scope of services provided by GTs should be published and not the commercial agreement itself. NGT expressed additional concerns regarding the application of activity based costing provisions to common systems provided by the Agency, and the need for paragraph 4 which refers to the procurement of services and systems on a common basis pursuant to the Agency Services Agreement.
- 5.93. One potential purchaser, whilst expressing support for the merger of the Common System Obligation condition and the Agency condition, stated that definition of terms such as 'common systems and procedures' would be helpful.
- 5.94. Another potential purchaser provided detailed drafting comments with respect to the ordering of the condition as well as a number of minor drafting comments.

### **Ofgem's proposals**

- 5.95. Having considered respondents' views, Ofgem is proposing a single licence condition that combines the provisions of the proposed Standard Special Condition A14 (Common System Obligations) and Standard Special Condition A15 (Agency) as published within the next steps document within a single new licence condition Standard Special Condition A15 (Agency).
- 5.96. Ofgem has addressed the concerns raised by respondents that the Agency condition as attached to the next steps document did not require GTs not to opt out of the Agency. This obligation has now been included within the proposed condition.



- 5.97. The proposed licence condition also makes it clear that the scope of the services and systems that will be delegated to the Agency will be set out in the UNC.
- 5.98. Ofgem notes that the scope of the Agency determined by the Authority in its Agency and Governance Arrangements decision document (Option C) referred to both services and systems and, as such, the merger of these provisions adds greater clarity in this regard. Ofgem will invite interested parties views in the Agency Service Agreement (ASA) through the DISG. Ofgem considers it important that NGT prepares the ASA as soon as possible following publication of this document to enable other participants to comment on the licence drafting and for Ofgem following consideration of respondents views to determine whether any additional licence drafting is required relating to this issue.
- 5.99. Ofgem notes NGT's concerns regarding the publication of the ASA, but would highlight that the provisions of paragraph 2 allow any information agreed as being confidential by the Authority to be excluded from the published version. Furthermore, Ofgem would note that systems form a key element of the activity based costing proposals, and that paragraph 4, which refers to the procurement of services and systems on a common basis pursuant to the Agency Services Agreement, is necessary.
- 5.100. Ofgem does not believe that it is necessary to define terms such as "common systems and procedures" and would re-state the policy intent, which is that a single provider, namely the Agency, provides the services and systems outlined within Option C of the Authority decision on Agency and Governance, which will be defined within the UNC.
- 5.101. Furthermore, Ofgem notes respondents' concerns regarding commonality of data formats. In order to address these concerns, Ofgem is proposing to introduce, into the vacated slot for Standard Special Condition A14, the provisions (in a modified form) of Standard Condition 38 (Availability of Data Formats), which has been strengthened to refer to Standard Special Condition A15, as discussed in Chapter 4.
- 5.102. Following consideration of respondents' views, Ofgem has also modified the drafting of Standard Special Condition A15 further, to improve the clarity of Standard Special Condition A15, including, but not limited to, the following modifications:

- ◆ the insertion of a requirement for the licensee and other relevant gas transporters by the date at which this condition becomes effective (unless the Authority consents otherwise in writing) to have entered into an Agency Services agreement (as indicated by paragraph 1 of this condition);
- ◆ a requirement for the scope of both services **and systems** within the Agency to be set out within the UNC, and for:
  - ◆ such services and systems to be established, operated and developed on an economic and efficient basis;
  - ◆ the costs of the Agency to be determined on an activity cost basis with clarification added regarding the meaning of this to alleviate the concerns expressed by NGT;
  - ◆ and for costs of the Agency to be allocated between the users of the Agency on a transparent basis;
- ◆ clarification that GTs cannot, without the consent of the Authority, and a consultation on such a request, opt-out of the agency arrangements (as indicated by paragraphs 5 and 6).

5.103. Ofgem invites respondents' views on its proposals for Standard Special Condition A15. The modified drafting for this condition is provided for comment in Appendix 8A.

5.104. Ofgem invites respondents' views on its proposals for Standard Special Condition A15. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition A16: Independence of the Independent Market for Balancing***

### **Next steps document**

- 5.105. In the next steps document, Ofgem stated that it was proposing to create a new licence condition to ensure the continuation of a market for balancing that is independent from all NTS and DN-GTs.

### **Respondents' views**

#### *NGT*

- 5.106. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchasers*

- 5.107. One potential purchaser accepted the applicability and the drafting of Standard Special Condition A16.
- 5.108. Another potential purchaser considered that the proposed drafting within the next steps document was incorrect on the grounds that the “balancing gas transporter” would be balancing the Great Britain gas pipeline system and not just the pipeline system of the balancing gas transporter.

#### *Shippers/suppliers*

- 5.109. No shipper/suppliers provided a detailed response to this licence condition within its formal response to the next steps document.

#### *DISG comments*

- 5.110. The drafting for Standard Special Condition A16 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 34). Ofgem presented the new drafting for Standard Special Condition A16 at DISG 33. DISG participants were broadly supportive of Ofgem’s proposals. The minutes of these meetings are included in Appendix 2.

- 5.111. Following consideration of respondents' views, Ofgem concluded that the drafting of Standard Special Condition A16 within the next steps document lacked clarity and did not meet Ofgem's policy intent.
- 5.112. As a result, at DISG 33, Ofgem presented revised drafting for this condition that recognised that the "energy balancing gas transporter" would be the NTS and that the NTS would be responsible for balancing the "total system", i.e. both the NTS and DN's. This is consistent with the Authority's decision regarding roles and responsibilities.<sup>51</sup>
- 5.113. Industry participants have provided detailed drafting comments both during these meetings and by written responses after this meeting.
- 5.114. Overall, respondents welcomed the increased clarity of the drafting. One shipper/supplier asked at the meeting whether this licence condition would capture trading at the National Balancing Point.

### **Ofgem's proposals**

- 5.115. Ofgem continues to believe that it is appropriate to introduce this licence condition to preserve independence in the provision of the market for balancing. Ofgem considers that the revised drafting of this condition is consistent with the Authority's decision regarding roles and responsibilities between the NTS and DN-GTs and as such is proposing to introduce Standard Special Condition A16 applicable to both NTS and DN-GTs.
- 5.116. In response to the concern expressed by a shipper/supplier as to whether this condition captures trades at the National Balancing Points, this condition includes provision regarding the NTS energy balancing and that the NTS would be required to balance its system as well as that of other GTs, consistent with the decision on roles and responsibilities.
- 5.117. Following consideration of respondents' views, Ofgem has modified the drafting of Standard Special Condition A16, to improve the clarity, including, but not limited to, the following clarifications:

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<sup>51</sup> National Grid Transco – potential sale of gas distribution network businesses. Allocation of roles and responsibilities between transmission and distribution networks. Decision document 119/04

- ◆ that the “energy balancing gas transporter” would be the NTS and that the NTS would be responsible for balancing the “total system” (as defined in Standard Special Condition A3), which includes the pipeline systems of all other relevant gas transporters;
- ◆ that “energy balancing” means the activity of the *residual balancing* of inputs of gas to, and offtakes from, the total system; and
- ◆ that the licensee *and any other relevant gas transporter which is owned by the holder of this licence, the licence for which is held in the same legal entity* must be independent from the operator of the independent market for balancing and shall not act in any manner which may prejudice the independence of the operator of the independent market for balancing.

5.118. Ofgem invites respondents’ views on its proposals for Standard Special Condition A16. The modified drafting for this condition is provided for comment in Appendix 8A.

5.119. Ofgem invites respondents’ views on its proposals for Standard Special Condition A16. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Standard Special Condition A17: General Obligations in respect of gas transporters’ pipe-line systems***

#### **Next steps document**

5.120. In the next steps document, Ofgem stated that it considered that a new condition would be required to ensure that NTS and DN-GTs did not prejudice the safe and efficient operation of each others’ networks.

5.121. Ofgem detailed that following consideration of the views expressed at DISG, it had reconsidered the drafting of the proposed condition and outlined that the

proposed drafting of this condition would draw on the wording included within Standard Condition 3 of the Gas Shipper's Licence. Ofgem considered that the use of such wording would be appropriate, particularly in view of the fact that the DTI was consulting on the granting of an exemption to NTS and DN-GTs from the need to hold a shipper licence to allow them to make arrangements with each other for the offtake of gas from the NTS. Ofgem also expressed agreement with views expressed through the DISG that the obligation should not relate to the planning, development and maintenance of other GT networks.

- 5.122. Ofgem set out that it would be inappropriate to extend this proposed condition into IGTs' licences through the DN sales process in the interests of best regulatory practice.

### **Respondents' views**

#### *NGT*

- 5.123. NGT agreed with Ofgem's proposals that a condition is required to ensure that NTS and DN-GTs act prudently and should not prejudice other GTs' systems.

#### *Potential purchasers*

- 5.124. One potential purchaser accepted the principle of a condition that requires IDNs to take account of other gas systems. This potential purchaser suggested that there should be an obligation on IDNs to operate their own pipelines reasonably and prudently, and for the obligation in paragraph 1 of this condition to be subordinate to such an obligation. This potential purchaser noted that nothing in this condition stated that the licensee should not prejudice the operation of its own system.
- 5.125. Another respondent welcomed the removal of references to planning, development and maintenance from this condition. However, this potential purchaser considered that paragraph 1 lacked clarity as there was the possibility for anything a network owner did to "affect" another pipeline system would breach this condition. Furthermore, it is unclear which activities would be unacceptable and what action would be required. This potential purchaser suggested that the licence should be amended to make clear what activities would be acceptable. This potential purchaser also questioned why paragraph 3

was required given the proposed commercial arrangements and associated incentive schemes for the booking and allocation of NTS exit capacity.

- 5.126. Another potential purchaser suggested that arguably many things that a transporter does may fall within sub-paragraphs (a), (b) and (c) of paragraph 2 (such as implementing emergency arrangements, interrupting its customers when the NTS is long on gas, and not interrupting its customer when the NTS is short on gas), but the transporter could have been pursuing that course of action because of its own statutory and licence and contractual obligations. This potential purchaser suggested that to avoid falling foul of this condition the licensee is almost better not communicating with other transporters to avoid having actual knowledge of what is going on. This potential purchaser also suggested that for this condition to work as envisaged, it required the NTS to keep the DN informed with all information relevant to this obligation. This potential purchaser also questioned the need for paragraphs 2 and 3.

#### *Shippers/suppliers*

- 5.127. No shipper/suppliers provided a detailed response to this licence condition with their formal responses to the next steps document.

#### *DISG comments*

- 5.128. The licence condition drafting for Standard Special Condition A17 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). The minutes of these meetings are attached in Appendix 2.

### **Ofgem's proposals**

- 5.129. Ofgem continues to consider that this licence condition should be introduced as Standard Special Condition A17 applicable to both NTS and DN-GTs.
- 5.130. Under the proposals for the new offtake arrangements and associated exemption from the prohibition on DN-GTs not to undertake shipping activities it is expected that the NTS and DN-GTs will be making arrangements for the offtake of gas. Given this obligation is currently in shippers licences, and that the potential effect for customers of either the NTS or DN-GTs prejudicing the operation of other GTs networks is considerable, Ofgem considers it reasonable

and proportionate to introduce this condition so as to protect the interests of customers.

- 5.131. In respect of the point raised by a potential purchaser that nothing in the condition prevents a GT from prejudicing its own network, Ofgem considers that, this is prevented by the general Gas Act obligations on GTs (i.e. to develop and maintain an efficient and economical pipeline system) and that this statutory obligation is supplemented by a number of more detailed licence conditions.
- 5.132. Ofgem accepts that there are situations where legitimate activities undertaken by GTs will affect each other's network. However, such activity will not cause GTs to breach this licence condition unless in carrying out such activity the GT is not acting as a "reasonable and prudent operator". Ofgem considers that this gives GTs sufficient protection in carrying out their activities in the same way as shippers are afforded the same protection.
- 5.133. In response to the issue raised by a respondent in relation to the need for paragraph 3, Ofgem accepts that such arrangements may be covered in the commercial arrangements and associated incentive scheme, but notes that the drafting of paragraph 3 provides extra clarity with respect to enforceability of such a requirement.
- 5.134. Ofgem invites respondents' views on its proposals for Standard Special Condition A17. The modified drafting for this condition is provided for comment in Appendix 8A.
- 5.135. Ofgem invites respondents' views on its proposals for Standard Special Condition A17. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.



## ***Standard Special Condition A40: Price Control Review Information***

### **Reasons for licence condition**

- 5.136. As set out in Chapter 3, in the next steps document, Ofgem noted that changes to conditions such as Standard Special Condition A30 (Regulatory Accounts) may be required to reflect developments occurring through the current DPCR 4 licence consultation process. As discussed in Chapter 4, Standard Special Condition A30 (Regulatory Accounts) has been revised in the light of the DPCR 4 consultation to bring such conditions into line across network licences. As such, Standard Special Condition A30 has been revised, with changes including (without limitation) the removal of the requirement to produce current cost regulatory accounts, and to move to a “fairly presents” rather than a “true and fair” auditor opinion.
- 5.137. However, as part of the proposed modification to the regulatory accounts provisions within the electricity DNO licences, a new licence condition relating to the provision of price control review information has also been introduced. In Ofgem’s view, this new condition is part of the package of changes to the information provision requirements of the electricity DNO licences as part of DPCR 4. As such, Ofgem now proposes to introduce the equivalent condition into the licences of NTS and DN-GTs.

### **Respondents’ views**

- 5.138. This new licence condition was proposed following the publication of the next steps document. Therefore, it has been discussed extensively in DISG, and respondents’ views on this condition are set out in the following paragraphs.
- 5.139. Following discussions at DISG 34, Ofgem has received comments on this condition from both NGT and potential purchasers. The minutes of the meeting are attached in Appendix 2.
- 5.140. NGT acknowledged that the introduction of this condition was a legitimate requirement, but expressed concern that the drafting proposed was unworkable as it could require Transco (for each licence) to:

- ◆ keep any records as Authority determines;
- ◆ at any time Authority chooses, produce any information the Authority determines, in any form; and
- ◆ be audited as the Authority determines.

5.141. NGT was concerned that this would be an unacceptable level of regulatory risk, in that Transco might be unable to comply with such open ended requirements, thus putting it in breach of its licences.

5.142. NGT stated that, until this can be resolved, the condition should be removed and replaced with an obligation to introduce it later this year. NGT argued that the condition was not strictly necessary upon network sales occurring and could be introduced later.

5.143. One potential purchaser stated opposition to the introduction of Standard Special Condition A40. This potential purchaser stated that this condition was extremely controversial, and had been the subject of extensive debate as part of the DPCR 4 process. This potential purchaser argued that the inclusion of such a condition was not necessary to facilitate DN sales and should therefore be removed.

5.144. Another potential purchaser stated that it would be reasonable for the Authority to give a minimum period of notice of 2 months before the start of the financial year, to allow licensees to have time to implement any necessary reporting arrangements.

### **Ofgem's proposals**

5.145. In Ofgem's view, the early, accurate and timely provision of information is key to capturing the benefits for customers of the DN sales transaction.

5.146. As a result, Ofgem proposes to commence work to develop the necessary price control review reporting rules that accompany this condition. This related consultation will be undertaken later in the year. The development of these reporting rules will draw heavily upon the lessons learnt and the format of the equivalent price control review reporting rules for electricity distribution. This will involve extensive industry consultation on the form and governance of such

guidelines. Ofgem will take into account all responses it receives in relation to the price control review reporting rules including information on licensees' costs.

- 5.147. However, to reflect the fact that these price control review reporting rules are not yet in place, this condition has been drafted such the licensee is not obliged to comply with the provisions of this condition until such a date as the Authority specifies by writing in a notice (where such a date is on or after the date on which the condition becomes effective). The licensee will therefore not be required to comply with the provisions of this condition until the necessary price control review reporting rules have been developed and a full industry consultation in this regard has taken place.
- 5.148. Furthermore, paragraph 3(b) recognises that there may be a lead time for licensees to implement the necessary reporting arrangements and therefore allows the use of estimates, where reasonable, in the first financial year (or part thereof).
- 5.149. Furthermore, the Authority would note that under the provisions of Standard Special Condition A26 (Provision of Information to the Authority) the licensee must furnish the Authority such information as it may reasonably require for the functions that it performs.
- 5.150. Ofgem invites respondents' views on its proposals to introduce Standard Special Condition A40. The drafting for this condition is provided for comment in Appendix 8A.
- 5.151. Ofgem invites respondents' views on its proposals for Standard Special Condition A40. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition A55: Enduring Offtake Arrangements***

### **Reasons for licence condition**

- 5.152. This licence condition was not consulted on as part of the next steps document and has been introduced following the Authority's January 2005 decision to grant its conditional consent to Transco's proposed disposal of DN assets to four wholly owned subsidiary companies.
- 5.153. As part of its January 2005 decision the Authority concluded that in order to protect the interests of customers the enduring offtake arrangements should be implemented by 1 September 2005.
- 5.154. In order to achieve this, the Authority imposed certain conditions to the consent granted to Transco to secure the implementation of the enduring offtake arrangements (including the enduring NTS exit capacity and NTS exit flexibility arrangements) on a best endeavours basis by 1 September 2005. These conditions are intended to apply within the period prior to hive-down and share sale and are discussed in detail in the Authority's February 2005 decision document.<sup>52</sup>
- 5.155. In addition, in its February 2005 decision document the Authority indicated that it intended to propose a number of licence conditions on Transco and the DNs relating to the implementation of the enduring offtake arrangements. These conditions would be intended to operate for the period following hive down and share sale.
- 5.156. In particular, the Authority indicated that it intended to propose licence conditions, binding upon Transco and each of the DNs, requiring them to use their best endeavours to implement the enduring offtake arrangements by 1 September 2005.
- 5.157. In addition, the Authority stated that it intended to propose, as part of the licence condition binding upon Transco, an obligation upon it to procure from NGT an

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<sup>52</sup> *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas*

undertaking to the Authority that it will use its best endeavours to ensure that that the enduring offtake arrangements will be implemented by 1 September 2005.

- 5.158. Further, the Authority stated that it intended to propose, as part of the licence condition binding upon each independent DN, an obligation requiring it to procure an undertaking addressed to the Authority from its ultimate controller that it will use its best endeavours to ensure that the independent DN implements the enduring offtake arrangements by 1 September 2005.
- 5.159. The Authority indicated that Ofgem would consult on these proposed licence conditions in February 2005 as part of the proposed section 8AA and associated section 23 licence modification proposals to Transco's existing GT licences.
- 5.160. As a result of the Authority's decision therefore, Ofgem is now consulting on the proposed licence conditions described above through the section 8AA and associated section 23 Notices that are attached to this document.

### **Respondents' views**

- 5.161. The drafting of this condition was presented at DISG 35. The minutes of this meeting are attached at Appendix 2 of this document. A number of comments were received from DISG participants both during and following the DISG meeting. A summary of these comments is set out below.
- 5.162. NGT noted that the conditions of consent drafted used the phrase "take steps to" in the context of the "best endeavours" obligation and noted that this phraseology was not replicated in the drafting of Standard Special Condition A55.
- 5.163. One potential purchaser stated that it was concerned with the use of 'best endeavours' within this licence condition. In particular, this respondent stated that it was concerned as the proposed licence drafting does not recognise that the obligation is a collective one. The potential purchaser stated that on its own a DN-GT licensee would not be able to fulfil this obligation. It believed that it would be more appropriate if this licence condition requires the licensee to use

its best endeavours in conjunction with and co-operation with all other relevant gas transporters.

- 5.164. One shipper/supplier stated that September 2005 would be an extremely tough date to meet, and requested that the Authority considers a more practical date such as 1 September 2006. Another shipper/supplier added that September 2005 refers to the date by which the event would have to be in place. This shipper/supplier stated that by this time it would need to buy capacity on this date for 2008. In this shipper/suppliers opinion, if the lead time could be reduced from three years to two years then this would be more workable.

### **Ofgem's proposals**

- 5.165. Following the Authority decision to grant its conditional consent, Ofgem proposes to introduce a new licence condition that will be applicable to all NTS and DN-GTs. This licence condition will require them to use their best endeavours to implement the enduring offtake arrangements (as described in Ofgem's November Final Impact Assessment) by 1 September 2005.
- 5.166. Ofgem has not incorporated the phrase "take steps to" as it is noted that this phrase was used in the context of the conditions precedent, and it is the conditions subsequent to hive-down that are of relevance in this instance.
- 5.167. This condition also requires that the licensee, the NTS and each DN, will obtain an undertaking from their respective ultimate controllers, that they will use best endeavours to ensure that the IDNs and Transco, as appropriate, implement the enduring offtake arrangements by 1 September 2005.
- 5.168. Without fettering the Authority's discretion with regards to enforcement, if licensees were to breach this condition Ofgem would consider the position between the role of Transco and the potential buyers of the DNs. As such, Ofgem will take into consideration the fact that the licence obligations apply to Transco as licensee in respect of all six GT licences until any share sale takes place and therefore it is Transco that initially is required to develop the proposals through a consultative process although it should be noted that the DNs do have a substantive role to play in progressing matters. Ofgem does not consider it appropriate to make the obligation a collective obligation. Any breach will be

assessed on a case by case basis and enforcement action taken as appropriate having regard to all the circumstances.

- 5.169. Ofgem invites respondents' views on its proposals for Standard Special Condition A55. The drafting for this condition is provided for comment in Appendix 8A.
- 5.170. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **Special Conditions applicable to the NTS**

#### ***Special Condition C1: Amendments to Standard Special Conditions relating to LNG***

##### **Next steps document**

- 5.171. As set out in Chapter 3, in the next steps document Ofgem stated that it would be appropriate for obligations relating to LNG storage to sit within the NTS licence only. As such, Ofgem proposed to introduce a new special condition upon the NTS, which would seek to augment the following standard special conditions:

- ◆ Standard Special Condition A3 - Definitions and Interpretation;
- ◆ Standard Special Condition A4 - Charging Gas Shippers – General;
- ◆ Standard Special Condition A5 - Obligations as Regard charging Methodology;
- ◆ Standard Special Condition A6 - Conduct of Transportation Business;
- ◆ Standard Special Condition A7 - Requirement to Enter into Transportation Arrangements in Conformity with the Network Code;

- ◆ Standard Special Condition A11 - Network Code;
- ◆ Standard Special Condition A26 - Provision of Information to the Authority;
- ◆ Standard Special Condition A27 - Disposal of Assets;
- ◆ Standard Special Condition A30 - Regulatory Accounts;
- ◆ Standard Special Condition A32 - Definition of Permitted Purpose;
- ◆ Standard Special Condition A33 - Restriction on Use of Certain Information and Independence of the Transportation Business;
- ◆ Standard Special Condition A37 - Availability of Resources; and
- ◆ Standard Special Condition A41 - Emergency Services to or on Behalf of Another Gas Transporter;

### **Respondents' views**

#### *NGT*

5.172. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchasers*

5.173. Potential purchasers were generally supportive of the proposal that the LNG provisions should apply to the NTS GT only. Two potential purchasers pointed out that the effect of reverting to references to storage facilities contained in the standard condition designated by the Secretary State was that references to offshore gas storage installations, storage cavities in natural strata and containers for the storage of gas in a liquid state were being reintroduced into the licences of DN-GTs. These references were not currently in Transco's licence and therefore the purchasers argued that their reintroduction was outside of the remit of DN sales.

5.174. One potential purchaser had a number of minor comments on the drafting of this condition. These were as follows:



- ◆ in relation to paragraph 3 it would help the reading of this paragraph if after the reference to “Standard Special Condition A3” there was inserted the words “(as amended by Special Condition C1)”; and
- ◆ in a number of places the paragraphs that were being introduced to replace paragraphs in other conditions were almost identical to the original paragraph. In those situations, it might be easier to change the particular words rather than the whole paragraphs.

#### *Shippers/suppliers*

- 5.175. No shipper/suppliers provided a detailed response to this licence condition within its formal response to the next steps document.

#### *DISG comments*

- 5.176. As set out in Chapter 3, the licence condition drafting for the Standard Special Condition C1 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 31 and DISG 34). Copies of the minutes of the meetings are attached in Appendix 2.
- 5.177. Industry participants have provided detailed drafting comments both during these meetings and by written responses after these meeting.
- 5.178. One potential purchaser stated their opinion that consistent with DISG 32, the definition of “LNG storage arrangements” should be amended so that reference is made to “and/or DN operators”. They explained that this was essential for, at the very least, the Scottish DN to be able to meet its Scottish Independent Undertaking (SIU) obligations.

#### **Ofgem’s proposals**

- 5.179. Given the nature of Special Condition C1, it has been necessary to make a number of consequential changes to the drafting of this condition to reflect changes to the drafting of the conditions that Special Condition C1 augments. As a result a number of the cross-references have changed from the version of the condition consulted upon in November. Furthermore, this condition no longer augments Standard Special Condition A26 (Provision of Information to the Authority) as the definition of “transportation business” that was being

augmented has been deleted from this condition as this term is not actually applied (as discussed in Chapter 4 in relation to Amended Standard Condition 24).

5.180. As a result, the following conditions are proposed to be augmented by Special Condition C1:

- ◆ Standard Special Condition A3 - Definitions and Interpretation (paragraph 1);
- ◆ Standard Special Condition A4 - Charging – General (paragraph 2);
- ◆ Standard Special Condition A5 - Obligations as Regard Charging Methodology (paragraph 3);
- ◆ Standard Special Condition A6 - Conduct of Transportation Business (paragraph 4);
- ◆ Standard Special Condition A7 - Requirement to Enter into Transportation Arrangements in Conformity with the Network Code (paragraph 5);
- ◆ Standard Special Condition A11 - Network Code and UNC (paragraph 6);
- ◆ Standard Special Condition A27 - Disposal of Assets (paragraph 7);
- ◆ Standard Special Condition A30 - Regulatory Accounts (paragraph 8);
- ◆ Standard Special Condition A32 - Definition of Permitted Purpose (paragraph 9);
- ◆ Standard Special Condition A33 - Restriction on Use of Certain Information and Independence of the Transportation Business (paragraph 10);
- ◆ Standard Special Condition A36 - Restriction on Activity and Financial Ring-Fencing (paragraph 11);

- ◆ Standard Special Condition A37 - Availability of Resources (paragraph 12);
- ◆ Standard Special Condition A41 - Emergency Services to or on Behalf of Another Gas Transporter (paragraph 13);

5.181. Furthermore, as discussed in Chapter 3, Ofgem is no longer proposing to include the designated standard condition wording for storage provisions within the standard special conditions applicable to NTS and DN-GTs as appropriate. As a result, the text of Special Condition C1 has been modified in this regard to reflect the fact that such wording no longer needs to be deleted before inserting the LNG Storage provisions for the NTS.

5.182. In response to a comment raised by a potential purchaser (set out above), the wording of Special Condition C1 has also been modified to make it clearer what the amendments are, and to limit the scope of the provisions that may fall outside of any private CLM procedure that may be applied to the Standard Special Conditions in Part A of the licence that are augmented by Special Condition C1. As a result, rather than deleting and inserting whole paragraphs, the drafting of Special Condition C1 has been modified such that the number of words being deleted and inserted is kept to a minimum.

5.183. Following consideration of respondents' views, Ofgem has modified the drafting of Special Condition C1 in other areas, to improve the clarity, including, but not limited to, the following clarifications:

- ◆ the use of titles and bold formatting to make the condition easier to understand and to clarify interpretation; and
- ◆ the clarification of definitions such that:
  - ◆ the "transportation and LNG storage business" is defined to be equivalent to the transportation business and the LNG storage business; and
  - ◆ the definition of "LNG storage arrangements" recognises (consistent with the proposed DTI exemption) that DN operators may also enter into such arrangements.

5.184. Ofgem invites respondents' views on its proposals for Special Condition C1. The drafting for this condition is provided for comment in Appendix 8C.

5.185. Ofgem invites respondents' views on its proposals for Special Condition C1. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Special Condition C1A: NTS definition of supply of transportation services***

5.186. This licence condition is required to amend the definition of "supply of transportation services" such that it is applicable to the NTS and reflects the fact that the NTS performs "balancing management" as defined in Standard Special Condition A3.

#### **Reasons for Licence Condition**

5.187. As discussed in Chapter 4, the definition of "supply of transportation services" in Standard Special Condition A3 has been modified such that it is consistent with the provisions of the prohibited procurement provisions elsewhere in the licence. However, given the division of roles and responsibilities<sup>53</sup> between the NTS and the DNs, the definition of "supply of transportation services" is necessarily different between NTS and DN-GT licensees. As a result, it has been necessary to create this new NTS Special Condition to amend the definition of "supply of transportation services" such that it is applicable to the NTS and reflects the fact that the NTS performs "balancing management" as defined in Standard Special Condition A3.

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<sup>53</sup> For more information on allocation of roles and responsibilities refer to the document *National Grid Transco – Potential sale of gas distribution network businesses – Allocation of roles and responsibilities between transmission and distribution networks* – Decision Document – May 2004 – 119/04.

- 5.188. The drafting of this condition has been discussed with DISG members, and Ofgem has not received any comments in this regard. As a result, Ofgem's proposals for this condition remain unchanged.
- 5.189. Ofgem invites respondents' views on its proposals for Special Condition C1A. The drafting for this condition is provided for comment in Appendix 8C.
- 5.190. Ofgem invites respondents' views on its proposals for Special Condition C1A. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale..

## ***Special Condition C6: Independent Market for Balancing***

### **Next steps document**

- 5.191. In the next steps document Ofgem stated that, following further consideration of the issues, it was proposing to create a new licence condition to ensure the continuation of a market for balancing that was independent from all NTS and DN-GTs.
- 5.192. Ofgem set out that the effect of this licence condition, combined with Standard Special Condition A11 was designed to largely replicate the current provisions on Transco set out in Amended Standard Condition 9 of its current GT licences.

### **Respondents' views**

- 5.193. No comments were received with respect to Ofgem's proposals for this condition following the next steps consultation document.

### *DISG comments*

- 5.194. The licence condition drafting for the Special Condition C6 has been discussed at a number of DISG meetings since publication of the next steps document

(DISG 29, DISG 33 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. Ofgem received no comments through DISG. The minutes of these meeting are attached at Appendix 2.

### **Ofgem's proposals**

- 5.195. Ofgem continues to believe that Special Condition C6 is necessary to augment the provisions of Standard Special Condition A11 (Network Code and UNC) for the NTS. Therefore, whilst this condition is new, it largely replicates the provisions of what are currently paragraphs 3(a), 3(b), 3(c) and 3(d) of Amended Standard Condition 9 of Transco's current licences.
- 5.196. Ofgem has modified the drafting of Special Condition C6 to improve the clarity of this condition, including, but not limited to, the following modifications:
- ◆ the renumbering of the paragraphs to reflect changes to the drafting of Standard Special Condition A11;
  - ◆ the rewording and clarification of paragraph 22A consistent with the drafting changes made to Standard Special Condition A16; and
  - ◆ clarification that the "operator" in paragraph 22C is the operator of the independent market for balancing.
- 5.197. Ofgem invites respondents' views on its proposals for Special Condition C6. The modified drafting for this condition is provided for comment in Appendix 8C.
- 5.198. Ofgem invites respondents' views on its proposals for Special Condition C6. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition C7: Charging obligations***

5.199. This licence condition is required to augment the charging obligations outlined in Chapters 3 and 4, and is intended to apply specifically to the NTS. As such, this section does not repeat the discussion of respondents' views and the next steps document that appears in Chapters 3 and 4 in relation to Amended Standard Condition 4 and 4A.

### **Reasons for licence condition**

5.200. As discussed in Chapters 3 and 4, the charging obligations consulted upon within the next steps document, as represented by Standard Special Conditions A4 and A5, were drafted on the assumption that charge change provisions would be common across NTS and DN-GTs with changes to charges on a twice yearly basis.

5.201. However, following the publication of the next steps document, Ofgem's understanding of the revenue flows between the NTS, the DNs and shippers has changed. As a result, Ofgem has decided, on the assumption that only NTS exit capacity and NTS exit flow flexibility related charges will be "passed through" from the NTS to DN-GTs and then onto shippers, that it is no longer appropriate for these charge change obligations to be common.

5.202. As such, Ofgem has modified its proposals such that:

- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to charges for flow flexibility and exit capacity once per year (on 1 October);
- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to all other transportation charges twice a year (1 October and 1 April); and
- ◆ DN-GTs will be obliged to use reasonable endeavours to make changes to transportation charges once per year (on 1 October).

## Ofgem's proposals

5.203. Given that these obligations now differ between the NTS and the DNs, it has been necessary to create two new conditions: an NTS Special Condition and a Standard Special Condition applicable to all DNs, such that the provisions of Standard Special Conditions A4 and A5 can be amended appropriately to reflect these differences. Special Condition C7 is the augmenting condition for the NTS. As such:

- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to charges for flow flexibility and exit capacity once per year (on 1 October); and
- ◆ the NTS-GT will be obliged to use reasonable endeavours to make changes to all other transportation charges twice a year (1 October and 1 April).

5.204. Ofgem would note that further modification of this condition may be required should the outcome of Transco's proposed pricing consultation result in further charges being passed through DNs from the NTS to shippers. Should such changes be required, these will be made as part of a section 23 licence modification process subsequent to hive-down.

5.205. As noted in Chapter 3, as well as introducing the different charge change obligations, Special Condition C7 reflects the DTI's proposed exemption, by inserting "and / or DN operators as appropriate" in paragraph 1(a) of Standard Special Condition A4.

5.206. Ofgem invites respondents' views on its proposals for Special Condition C7. The drafting for this condition is provided for comment in Appendix 8C.

5.207. Ofgem invites respondents' views on its proposals for Special Condition C7. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.



***Special Condition C19: Undertaking from the Ultimate Controller concerning non-discrimination between the NTS transportation activity and the Distribution Network transportation activity***

**Next steps document**

- 5.208. As set out in Chapter 3, in the next steps document Ofgem proposed to introduce new conditions in accordance with its decision to require structural separation of Transco's NTS and RDN businesses. To facilitate this separation Ofgem proposed to introduce special conditions into Transco's NTS licence. Ofgem stated that one of these new licence conditions would require the NTS licensee to obtain an undertaking from its parent company to apply the arrangements between the NTS and RDNs on the same basis as contracts entered into with non-affiliate businesses. A draft of this condition was attached to the next steps document.

**Respondents' views**

*NGT*

- 5.209. NGT stated it had consistently argued that the scope for undue discrimination by a network monopoly business is narrower 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.

*Potential purchasers*

- 5.210. Two of the potential purchasers were supportive of the inclusion of this condition. One potential purchaser stated that such an undertaking, would ensure a level playing field between the RDNs and the IDNs.
- 5.211. A potential purchaser provided some detailed comments on the drafting of the condition, and questioned whether it would be more appropriate for the undertaking to be in favour of the Authority as opposed to the licensee. The potential purchaser stated that this may be needed as it is concerned that the

time at which it would expect the licensee to enforce the undertaking, is at a time when the licensee is presumably in breach. This potential purchaser also stated that a mirror condition should be put in place in relation to the RDNs.

#### *Shippers/suppliers*

- 5.212. No shipper/suppliers provided a detailed response to this licence condition within its formal response to the next steps document.

#### *DISG comments*

- 5.213. The licence condition drafting for Special Condition C19 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29 and DISG 34). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are attached in Appendix 2.

#### **Ofgem's proposals**

- 5.214. Ofgem continues to consider it appropriate to introduce this licence condition as part of a package of measures designed to largely replicate legal separation. These measures are designed to protect customers from any undue discrimination between Transco's NTS and RDNs and other users of the system including IDNs.
- 5.215. In relation to the issue raised by a potential purchaser, Ofgem is of the view that an undertaking from the ultimate controller in favour of the licensee is the appropriate mechanism to ensure separation of the NTS and RDN businesses. However, an additional paragraph (paragraph 2) has been introduced, consistent with the drafting of Standard Condition 45 regarding the enforceability of such an undertaking.
- 5.216. Ofgem also notes that this condition will also ensure that the NTS will not enter into terms or agreements with its RDNs which unduly differ to corresponding arrangements entered into with the IDNs and will therefore facilitate a level playing field between the DN operators.

- 5.217. In relation to the issue relating to a requirement for a mirror condition to be placed on RDNs, Ofgem has considered this issue further but is of the view that, as there are no arrangements whereby the RDN business provides services to both the NTS and the IDNs, and therefore, a mirror requirement is not necessary.
- 5.218. Ofgem has modified the drafting of Special Condition C19 to improve the clarity of this condition, including (but not limited to) the rewording of certain aspects of paragraphs 1 and 2 to reflect the approach to definitions of “relevant gas transporter” and “DN operator” throughout the licence and to acknowledge respondents’ views expressed regarding the clarity of paragraph 1.
- 5.219. Ofgem invites respondents’ views on its proposals for Special Condition C19. The drafting for this condition is provided for comment in Appendix 8C.
- 5.220. Ofgem invites respondents’ views on its proposals for Special Condition C19. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition C20: Separation of NTS and Distribution Network Businesses***

### **Next steps document**

- 5.221. In the next steps document Ofgem stated that the Authority had reviewed its “minded to” decision on legal separation as a result of issues associated with its implementation. In this regard Ofgem detailed that it had developed a set of licence obligations, designed to address the issues that could arise as a consequence of the Authority decision not to require legal separation.
- 5.222. Ofgem stated that the Authority’s views in relation to targeted structural separation, which were previously set out in the Offtake Arrangements Conclusions document, remained unchanged. Ofgem explained that Transco would be required to have a statement in place describing the practices,

procedures and systems it had adopted to ensure no undue discrimination between RDN and IDN businesses. Ofgem outlined that, in particular, the statement would set out how, and to what extent, Transco would maintain informational, operational and physical separation between the NTS and RDN businesses so as to prevent any breach of the requirement for no undue discrimination by the NTS.

- 5.223. However, Ofgem did not provide drafting for such a condition within the next steps document, but rather committed to bring such drafting to the DISG for discussion.

### **Respondents' views**

#### *NGT*

- 5.224. NGT did not provide a detailed response to this licence condition within its formal response to the next steps document.

#### *Potential purchases*

- 5.225. One potential purchase stated that it supported the inclusion of this licence condition. Another potential purchaser stated that given the importance of the statement, describing the practises and procedures adopted by the licensee to comply with this licence condition should not be subject to deemed approval by the Authority.
- 5.226. This potential purchaser also stated that it considered that the use of term “managerial boards” within the condition could be confusing. This potential purchaser stated that, if the ‘managerial boards’ are not required to be boards in the corporate sense, it may be better to recognise that by calling them ‘managerial committees’ or ‘managerial executives’, thus keeping the word ‘board’ to mean the board of directors of Transco plc. .
- 5.227. This potential purchaser also stated that given the importance of the statement in ensuring separation of the NTS and RDN’s there should be an absolute obligation, or at least a bests endeavours obligation on Transco to comply with this licence condition.

#### *Shipper/supplies*

5.228. A shipper/supplier stated that the provisions relating to separate management boards are helpful, but considered that there should be a requirement that a certain proportion of the members of these boards may not be members of both boards, to ensure a healthy balance of views. It is recognised that those members of the Transmission Executive Committee/Distribution Executive Committee (TEC/DEC) who are also members of the Transco plc Board, are likely to be in common, and therefore some form of Code of Conduct may be required.

*DISG comments*

5.229. Ofgem consulted on the initial drafting of Special Condition C20 at DISG 30 and DISG 34 and invited comments from DISG members. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are contained in Appendix 2.

5.230. The special condition as discussed at DISG included obligations to:

- ◆ have in place managerial and operational systems necessary to ensure that the licensee complies with the obligations contained in Standard Special Condition A6 (Conduct of Transportation Business) (which includes the obligation on the NTS to ensure that the RDNs do not obtain a commercial advantage from the operation of the NTS transportation activities) and Standard Special Condition A35 (Prohibition of Cross Subsidies);
- ◆ have in place a statement describing the practices, procedures and systems which the licensee has adopted (or intends to adopt) to secure compliance with the above obligation. The statement shall in particular set out (amongst other things) how the NTS will maintain appropriate managerial and operational independence of the transportation business (including the establishment of separate managerial boards); and
- ◆ use best endeavours to comply with the statement. (An initial version of this condition contained a reasonable endeavours obligation. This was changed to best endeavours in response to comments raised mainly by potential purchasers).

- 5.231. NGT stated that the inclusion of the best endeavours obligation was excessive and inappropriate. NGT stated that it would be perverse to apply a standard to an area of activity that carries lower risk and consequence than other areas (e.g. monopoly / competitive business separation).
- 5.232. Furthermore, this shipper/supplier suggested that it would be helpful to list explicitly under the separation conditions, which, if any, shared services may be provided and how. Under paragraph 2, practices and procedures which the licensee may adopt, are mentioned. If these practices and procedures are necessary for separation but have not been implemented by 1st May, this shipper/supplier is of the view that a specific time limit for implementation should be given, perhaps tied to the date of share sale, to give confidence to participants that stringent protections are in place.
- 5.233. Another shipper/supplier stated that NGT's proposed merger of Transco Metering Services (TMSL) and Onstream needs to be considered in the light of this condition. Paragraph 10 states that the licensee's "Metering Business" (i.e. TMSL who currently undertake work on behalf of the licensee) is included in the definition of transportation business and therefore needs to restrict the use of this information to its "Meter-Related Services Business" (which this shipper/supplier assumes to be Onstream who undertake competitive meter work).

### **Ofgem's proposals**

- 5.234. Ofgem continues to consider it to be necessary to introduce a new licence condition (Special Condition C20) to require the NTS GT to put in place and maintain managerial and operational independence (including the establishment of separate managerial boards) to ensure that the licensee complies with the obligations of Standard Special Condition A6 (Conduct of the Transportation Business). The licensee is further required to have in place a statement, approved by the Authority, describing the practices, procedures and systems adopted in this regard.
- 5.235. Following consideration of respondents' views, the drafting of Special Condition C20, as presented at DISG 30, has been subject to certain modifications, including, but not limited to, the following (as presented at DISG 34):

- ◆ clarification of the drafting of paragraph 5 such that “at least two” members of the managerial boards shall be directors of Transco plc; and
- ◆ changing “all reasonable measures” to “all best endeavours” in paragraph 7.

- 5.236. Ofgem notes NGT’s comments regarding consistency with equivalent provisions for the separation of monopoly and competitive businesses. Ofgem agrees that such obligations should be consistent, and, as discussed in Chapter 4, the obligations within Standard Special Condition A33 (Restriction on Use of Certain Information and Independence of the Transportation Business) have been changed to “best endeavours” obligations as well.
- 5.237. Ofgem agree with comments from shippers/suppliers that the industry needs to be confident that arrangements have been successfully implemented in relation to this licence condition. Ofgem will be consulting on Transco’s proposals to comply with its obligations under this licence condition through DISG. If Ofgem is unsatisfied with Transco’s proposals then Ofgem will consider further modifications as part of the section 23 processes planned for May.
- 5.238. Ofgem notes the concern of the shipper/supplier in relation to the potential merger of TMSL and ONstream. Ofgem considers these developments to be outside the scope of DN sales but will take these views into account in considering its response to NGT’s proposals in this area.
- 5.239. Ofgem invites respondents’ views on its proposals for Special Condition C20. The modified drafting for this condition is provided for comment in Appendix 8C.
- 5.240. Ofgem invites respondents’ views on its proposals for Special Condition C20. Ofgem notes that, following consideration of respondents’ views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority’s consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Special Condition C21: Appointment and duties of the business separation compliance officer***

### **Next steps document**

- 5.241. In the next steps document, Ofgem stated that special conditions would be introduced into Transco's NTS licence with, in addition, a special condition in Transco's RDN licence requiring the DNs to use reasonable endeavours to comply with the statement produced by the NTS pursuant to its licence obligations.

### **Respondents' views**

- 5.242. Views expressed by respondents on the principles of business separation between Transco's NTS and RDN businesses were discussed in Chapter 3. Below, we summarise the views expressed by respondents in relation to the licence drafting presented at the DISG.

### *DISG comments*

- 5.243. Ofgem presented the initial drafting of Special Condition C21 to DISG 30 and invited comments from DISG members. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of this meeting are included in Appendix 2.
- 5.244. This proposed condition requires Transco to appoint a business separation compliance officer for the purpose of facilitating compliance by the licensee with Standard Special Condition A6, Special Condition C20, Special Condition C19 and Standard Special Condition A35. It also requires the licensee to establish a compliance committee for the purpose of overseeing and ensuring the compliance of the licensee with its duties under Special Condition C20. The condition sets out some duties and tasks that will be assigned to the compliance officer including:
- ◆ providing advice and information to the licensee and the compliance committee for the purpose of ensuring the licensee's compliance with the relevant duties;



- ◆ monitoring the effectiveness of the practices, procedures and systems adopted by the licensee in accordance with the statement referred to at paragraph 2 of Special Condition C20; and
- ◆ investigating complaints or representations made from any person in respect of a matter arising under the relevant conditions.

5.245. One potential purchaser stated that, in relation to this licence condition the compliance committee, as a sub committee of the board of Transco plc, should report to that board as well as to the audit committee of the ultimate controller. This potential purchaser stated that Ofgem had indicated that Transco would have an audit. However this respondent pointed out that the licence conditions do not require this and they should do so.

5.246. A shipper/supplier noted that the condition makes explicit the duties of the compliance officer, and that they shall be provided with appropriate resource, but the duties are drawn in terms of the tasks the licensee considers it appropriate to assign to him. In view of this, this shipper/supplier suggests that it would seem sensible that the condition should require an independent audit opinion as to whether the activities of the compliance officer are sufficient to ensure compliance with the assigned licence conditions. It would be useful to include a summary statement of this opinion in the published report. The same principles could usefully be applied to the compliance activities specific to NGT as well.

### **Ofgem's proposals**

5.247. Ofgem continues to consider it appropriate to introduce a new licence condition (Special Condition C21) requiring the licensee to appoint a "business separation compliance officer" to facilitate compliance with Standard Special Condition A6 (Conduct of Transportation Business), Special Conditions C19 (Undertaking from Ultimate Controller re Non-Discrimination) and C20 (Separation of NTS and DN Businesses) and Standard Special Condition A35 (Prohibition of Cross Subsidies). Furthermore, Ofgem considers that the licence condition should require the licensee also to establish a compliance committee (which shall report to the audit committee of the ultimate controller) to oversee the duties and tasks of the business separation compliance officer.

- 5.248. Following consideration of respondents' views, the drafting of Special Condition C21 presented at DISG 30 has been subject to some minor editorial modifications.
- 5.249. In relation to the views expressed by the shipper/supplier that the audit report should cover whether the activities of the compliance officer have been sufficient to meet the licence condition requirements, Ofgem believes that this condition is drafted so that the compliance committee shall report to the audit committee. The compliance committee is obliged under this licence condition to oversee and ensure the performance of the duties and tasks of the business separation compliance officer set out within this condition. Ofgem believes that, as drafted, this licence condition already addresses the shipper/supplier's comments.
- 5.250. Ofgem continues to consider that a independent audit is important, however, Ofgem believes that it is not necessary to incorporate this requirement into the licence at this stage. Ofgem will continue to consult further on these issues through DISG.
- 5.251. Ofgem invites respondents' views on its proposals for Special Condition C21. The modified drafting for this condition is provided for comment in Appendix 8C.
- 5.252. Ofgem invites respondents' views on its proposals for Special Condition C21. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## **Standard Special Conditions applicable to all DN-GTs**

### ***Standard Special Condition D6: Provision of First Call Emergency Response to the Operator of the NTS***

#### **Next steps document**

- 5.253. As set out in Chapter 3, in the next steps document Ofgem stated that a new licence condition would be introduced to require DNs to provide first line emergency response to the NTS.
- 5.254. Appendix 7B of the next steps document provided licence drafting obliging DNs to provide emergency services to make safe any emergency on the NTS. The next steps document stated (in error) that such services should be provided to the NTS at a reasonable rate, although the actual licence drafting did not include such an obligation.

#### **Respondents' views**

##### *NGT*

- 5.255. As discussed in Chapter 3, NGT stated that they welcomed the inclusion of this licence condition.

##### *Potential purchasers*

- 5.256. As discussed in Chapter 3, potential purchasers raised concerns with Ofgem's statement that the costs of the provision of first response emergency services to the NTS service are already within DN price controls, and stated a concern that the lack of charging arrangements may place perverse incentives upon the NTS.
- 5.257. One potential purchaser accepted the obligation to provide this service but stated that NGT had made clear that DN staff would not be authorised to work on the NTS network, and that any such staff would be used for little more than "incident control" at any incident on the NTS. The potential purchaser considered that this should be clarified within the licence condition.

- 5.258. Another respondent suggested that it was not appropriate that, if requested by the NTS to do so, the DN must carry out physical work on, or exercise control over, the NTS as this could have potential safety and cost implications. Therefore this potential purchaser stated that the DN-GTs should retain the ability to agree to such a request. A further potential purchaser suggested that the condition should clarify that the DN would not be required to carry out any physical works to any part of the NTS but only to attend the scene of the incident, to take reasonable steps to cordon the area off and to take reasonable steps to keep the general public (with the assistance of the emergency services as appropriate) away from the scene of the incident until such time as the personnel of the operator of the NTS are able to attend the scene.
- 5.259. A potential purchaser suggested that some terms of proportionality should be included in the condition. Another potential purchaser stated that this condition should be amended so that it is clear that nothing in the condition would require additional training of DN staff. Another potential purchaser also stated that the condition should make clear that the licensee should not be obliged to provide emergency services a long way out of its DN area.

*Shippers/suppliers*

- 5.260. Shippers/suppliers did not have any comments in relation to emergency first response to the NTS other than the general comments summarised in Chapter 3.
- 5.261. DISG comments
- 5.262. As stated in Chapter 3, the drafting of this condition was presented at DISG 29, DISG 32 and DISG 34. At DISG 29, Ofgem highlighted that the next steps had contained an error regarding the ability of the DN GTs to make a reasonable charge for the provision of emergency services to the NTS and emphasised that, because the DN workforce that currently provides this service was already funded within the DN price controls, the DNs should not receive payment for the provision of such services within the current price control. The minutes of these meetings are attached at Appendix 2.
- 5.263. At the DISG meetings potential purchasers expressed concern regarding Ofgem's position that the monies for the provision of this service are already reflected within the DN price controls.

- 5.264. Comments were received from a potential purchaser after DISG 32. This potential purchaser stated that further clarity was needed as to what was meant by the requirement for the DN-GTs to act in a 'best manner'. This potential purchaser stated that it continued to believe that it is not appropriate for it to work on the NTS even if requested to do so. This potential purchaser stated that this could have potential safety and cost implications.
- 5.265. Following the discussion of revised drafting to address some respondents' concerns regarding the nature of work that DN-GTs would be required to carry out, at DISG 34, a potential purchaser stated that they continued to be concerned that the NTS could request the DN to carry out work on the NTS that could put the DN in a compromised position if such work was outside the DNs' skill set and/or authorisation. This potential purchaser therefore stated that their firm belief was that a DN must have the right to agree to such a request (which could not be reasonably withheld).

### **Ofgem's proposals**

- 5.266. As set out in Chapter 3, Ofgem continues to consider it appropriate to introduce a new licence condition requiring the DN-GTs to provide a first line emergency response service to the NTS, and that the costs for the provision of such a service are already contained within the current price control settlements.
- 5.267. When Transco accepted the current price control settlement its DN field force would have been required to provide first response service to the NTS and, moreover the efficient level of costs of providing this service would have been included in the allowed operating expenditure of the DN field force. Ofgem therefore continues to maintain that the cost of these services are allowed for in the present price control for DNs and does not consider it appropriate to include a provision in the licences for DNs to recover a reasonable amount for providing this service to the NTS. Ofgem does however believe that the issue of cost recovery for these services will need to be examined at the next price control review.
- 5.268. Ofgem is of the view that the issue of indemnities for DNs against third party claims is not an issue that should be dealt with by the licence, but is rather a commercial issue between the potential purchasers and Transco.

- 5.269. Ofgem does not believe that it would be appropriate for DNs only to provide emergency services within their DN area. Such a restriction would not be appropriate for managing a major incident, and would comment that the practicalities of 'first response' should limit the geographical area that is called upon in any event. The spirit of this condition is that it is the DN who is closest to the incident which would generally provide the 'first response'.
- 5.270. Following consideration of respondents' views, and consultation with the HSE, Ofgem has endeavoured to add further clarification regarding the nature of the work that DNs would be expected to undertake. As a result, paragraph 2 of this condition has been amended such that it no longer states "avoiding risk to life or property" as an instance when the DNs may be expected to carry out work on or exercise any control over the NTS. As a result, the DN-GT shall not be required to carry out any physical work on the NTS unless the NTS operator requests or authorises otherwise. This is to ensure that at a future date, this condition does not preclude the DN-GTs for undertaking such work.
- 5.271. The definition of "first call emergency response" has also been modified such that it is subject to paragraph 2.
- 5.272. Further modifications have been made to ensure consistency with definitional changes made in other parts of the licence.
- 5.273. The HSE is content with the wording of this proposed licence condition.
- 5.274. Ofgem invites respondents' views on its proposals for Standard Special Condition D6. The drafting for this condition is provided for comment in Appendix 8D.
- 5.275. . Ofgem invites respondents' views on its proposals for Standard Special Condition D6. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition D8: Reform of Distribution Network Interruption Arrangements***

### **Next steps document**

- 5.276. As stated in Chapter 3, in the next steps document Ofgem stated that it was concerned that, in the longer term, inconsistency of approach between the NTS arrangements and DN arrangements for interruption could lead to inefficiencies and, ultimately, costs for customers. Ofgem considered that although reform of the arrangements for interruptions for sites connected to DNs was not necessary for the proposed transaction to proceed, it would be appropriate to review the DN arrangements for interruptions in the near future.
- 5.277. Ofgem stated that any new reforms would need to address Ofgem's concerns in this area, and be consistent with the GTs' statutory duties. In addition Ofgem detailed that the review would be subject to the normal consultation process, including an impact assessment.
- 5.278. Ofgem therefore proposed to introduce a standard special licence condition applicable to all DN-GTs that would place a reasonable endeavours obligation upon DNs to review and develop proposals for the reform of transportation arrangements relating to the interruption of supply points within the DNs with effect from 1 April 2006.

### **Respondents' views**

#### *NGT*

- 5.279. NGT suggested that the drafting could be tightened up to make it clear that the intent of the condition was to require DNs to develop proposals, rather than for any such proposals to be implemented, by 1 April 2006.

#### *Potential purchasers*

- 5.280. One potential purchaser expressed its support for the proposed requirement to proceed with reform by April 2006, on a reasonable endeavours basis which recognises the importance of delivering the restructured industry as soon as possible.

5.281. Another potential purchaser was concerned that this condition placed an obligation on the DN-GTs to develop proposals for reform of these arrangements where, quite clearly, it would only be appropriate to do so once a full analysis and impact assessment had been carried out to justify such a reform. A potential purchaser stated that Ofgem had repeatedly stated that reform of the DN exit arrangements would be subject to a separate regulatory impact assessment following the DN sales process and that the proposed condition, as drafted, maybe inconsistent with this approach.

*Shippers/suppliers*

5.282. One shipper/supplier considered that it would be helpful to widen the obligation to require the DN-GTs to work together and with the NTS to bring forward joint proposals for reform of the DN interruption regime rather than placing the obligation at an individual network level, with the associated risks of incompatibility.

5.283. Another shipper/supplier objected to the introduction of licence conditions on the DN-GTs in respect of interruption reform on the grounds that changes to the DN interruption regime are not a requirement for the DN sales in the first place. This shipper/supplier suggested that Ofgem's commitment to do an impact assessment on any potential reform only further undermined its argument that this licence condition should be included as part of the section 8AA process. This respondent further stated that, if reform is desired by customers or shippers, a review modification could be raised.

5.284. Another shipper/supplier expressed concerned that introducing such a licence condition would create a momentum for change to be introduced within very short lead times (1 year potentially) and would limit shippers' opportunities to influence such changes. This respondent considered that this condition was neither appropriate nor necessary; however, it stated that if retained, the proposed date in paragraph 1 should be changed to 1st April 2008 (in line with the next price control) to facilitate full participation from shippers and other interested parties.



### *DISG comments*

- 5.285. As stated in Chapter 3, the drafting of this condition was discussed further at DISG 29, DISG 32 and 34. At this meeting, Ofgem clarified that the obligation in the proposed condition was for DNs to use reasonable endeavours to put forward proposals which would give effect to DN interruption reform on 1 April 2006. The minutes of these meetings are attached at Appendix 2.
- 5.286. Following discussions at DISG, NGT reported back on a meeting it had had with consumer groups who were particularly concerned that each distribution network might develop differing transportation regimes. NGT suggested that the licence condition be amended to ensure that there was a coordinated approach to the reform of transportation arrangements.
- 5.287. NGT considered that the 1 April 2006 date for bringing proposals for DN interruption reform into effect was unrealistic due to:
- ◆ insufficient time for suppliers to modify their customer agreements;
  - ◆ insufficient time to develop systems; and
  - ◆ key stakeholders being unlikely to invest time in any development process until after the DN sales process is complete.
- 5.288. NGT therefore suggested that the target be changed to oblige DNs to raise a formal modification by 1 April 2006.
- 5.289. A potential purchaser stated that inclusion of this condition as part of DN sales was inappropriate, particularly given that no cost benefit analysis had been carried out to justify such a reform.

### **Ofgem's proposals**

- 5.290. Following consideration of respondents' views Ofgem continues to consider that it is appropriate to introduce the proposed licence condition (Standard Special Condition D8) as published with the next steps document (other than a minor editorial modification to paragraph 1).
- 5.291. Ofgem continues to consider that the need for reform of the arrangements for interruption of sites connected to a DN is increased by the sale of the DNs.

Although Ofgem considers that it is not appropriate to introduce reforms in this area as part of the sales process itself, Ofgem is concerned that there may be significant risk to customers if the current arrangements continue into the medium to long term, particularly given the changes that are required for the interruption arrangements at the NTS level that the Authority considers necessary to protect the interests of customers if the sale proceeds. Ofgem therefore considers that the introduction of the proposed licence condition enables the transaction to proceed as planned (subject to other conditions) whilst protecting the interests of customers.

- 5.292. Ofgem recognises that the implementation of proposals relating to DN interruption reform by April 2006 is a challenging target. However, this has consistently been Ofgem's position and is consistent with the Authority's decision in this area. Ofgem has continually stated that the introduction of such reform will be subject to a full cost benefit analysis and full consultation with interested parties. Ofgem does not agree that a licence obligation requiring DNs to bring forward proposals for DN interruption reform for implementation by April 2006 is inconsistent with its stated approach that any such reform will be subject to a full cost benefit analysis. Rather DNs need to take into account the timescales required for consultation in establishing their proposals.
- 5.293. In respect of the comments raised by respondents regarding the need for DN-GTs to co-ordinate in respect of the development of these proposals, Ofgem reiterates that a full cost benefit analysis will be performed in advance of implementing any proposed reforms. Therefore the implementation of disparate regimes would need to be demonstrably the best outcome for customers to be adopted by the Authority. However, Ofgem considers that further customer benefits may be achievable as a result of a number of alternative reform proposals being developed, and as such has not modified the drafting of this licence condition in this regard.
- 5.294. Ofgem invites respondents' views on its proposals for Standard Special Condition D8. The drafting for this condition is provided for comment in Appendix 8D.
- 5.295. Ofgem invites respondents' views on its proposals for Standard Special Condition D8. Ofgem notes that, following consideration of respondents' views,

further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### ***Standard Special Condition D10: Provision of Connections Information.***

#### **Next steps document**

5.296. In the next steps document, Ofgem stated that there was a need to introduce a new licence condition to impose overall standards of performance, with a target overall performance of 90%, on all DN-GTs in relation to the following activities:

- ◆ the provision of quotations for providing new or altered connections;
- ◆ the provision of information in response to land enquiries and the approval or rejection of designs submitted by independent connection providers; and
- ◆ substantial completion of site works.

5.297. The new licence condition would also require the DN to provide:

- ◆ a scheme through which customers can challenge the accuracy of quotations and receive funds in respect of incorrect quotations; and
- ◆ specified information to the Authority on at least a quarterly basis and to carry out audits of samples of quotations as proposed by the licensee and agreed by the Authority.

5.298. The next steps document outlined that the quotation performance will be measured in relation to the following customer groups:

- ◆ standard quotations for gas loads up to and including 275kWh per hour, i.e. a U24 meter;

- ◆ non-standard quotations for gas loads up to and including 275kWh per hour; and
- ◆ non-standard quotations for gas load exceeding 275kWh per hour.

5.299. The new standards will not apply to connections at pressures above 7 bar, to new multiple residential or industrial developments containing more than six premises or to complex connections, for example, connections involving railway crossings. DNs will be required to submit proposed categories of connections that should be classed as complex to the Authority for approval.

### **Respondents' views**

5.300. The views of respondents relating to the principle of this licence condition and whether it should be applicable to all DN-GTs are outlined further in Chapter 3. The views of respondents relating to the drafting of the proposed Standard Special Condition for DNs are summarised here.

#### *NGT*

5.301. NGT is generally content with this licence condition. NGT considers that the proposed standards provide adequate protection for customers where competition may be limited, as well as providing sufficient headroom to encourage competition, whilst providing the minimum level of protection in the non-domestic market.

#### *Potential purchasers*

5.302. As discussed in Chapter 3 in respect to connections, one potential purchaser supports the approach of including appropriate connections standards in performance standards, and in general accepted the draft licence conditions proposed to deal with this issue.

5.303. One potential purchaser suggested that whilst the requirements may be applicable to Transco, they are disproportionately onerous upon new DN owners. This respondent suggested changes to the DN drafting and definitions for the frequency of audits, thresholds for connection standards, land enquiries, and specified connection information. Two potential purchasers suggested amendments to the timescales for responding to enquiries.

### *Shippers/suppliers*

- 5.304. As discussed in Chapter 3 in respect to connections, four shippers/suppliers supported placing obligations on all GT licensees to ensure that current obligations that are placed on Transco with regards to standards of performance in relation to connections continue to apply. One of the respondents stated that, as drafted, the proposals did not yet deliver the right behavioural incentives on gas transporters in particular for Transco.

### *DISG comments*

- 5.305. The licence condition drafting for Standard Special Condition D10 has been discussed at a number of DISG meetings since publication of the next steps document (DISG 29, DISG 33 and DISG 35). Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.
- 5.306. One potential purchaser expressed the view that this condition did not need to be part of the DN sales process. They further expressed concern that individual DNs would find 95% standards tougher to meet than a national company, and that the standard should apply to each RDN separately. Some potential purchasers suggested that a 'soft landing' approach be adopted whereby DNs would be allowed to work to less exacting standards for the first six or twelve months following the transfer of DNs from NGT to new owners
- 5.307. Another potential purchaser expressed concern that overall standards would be set in the licence, which would mean that a failure to meet standards would result in a breach of licence.

### **Ofgem's proposals**

- 5.308. Following receipt of written responses and in the light of discussions at an industry workshop on 26 January 2005, together with subsequent discussions at the DISG 35, Ofgem now proposes a simplified regime by:
- ◆ Introducing identical target deadlines in the licence condition (overall standards) and statutory instrument (guaranteed standards of performance) that will introduce guaranteed standards of performance;

- ◆ A substantially reduced audit requirement that requires a DN to provide details of its internal connections audit process and to undertake an annual audit, the results of which are to be provided to the Authority;
- ◆ The retention of 90% targets for each of the overall standards;
- ◆ All jobs that require site visits to be allowed longer target deadlines;
- ◆ Specified information requirements in respect of DN performance on all quotations including quotations classed as 'complex' or 'excluded';
- ◆ Categories of 'complex' and 'excluded' quotations to be proposed by DNs and agreed by the Authority;
- ◆ The provision of a commencement date and substantial completion date to be the subject of a new overall standard; and
- ◆ Application of standards on a DN specific basis i.e. NGT and DN buyers will be required to achieve the standards in each of their DN areas

5.309. Some potential purchasers suggested that a 'soft landing' approach be adopted whereby DNs would be allowed to work to less exacting standards for the first six or twelve months following the transfer of DNs from NGT to new owners.

5.310. Ofgem does not consider it appropriate to adopt a "soft landing" approach. The standards are intended to incentivise both NGT and DN buyers to provide reasonable levels of service both initially and on an on-going basis and to take appropriate actions to ensure connection customers are not disadvantaged as a result of the DN sales process. It would not be appropriate to rely on the standards of performance separately proposed by Ofgem which can only apply to customers/prospective customers of suppliers.

5.311. Some shippers/suppliers supported increasing the 90% target performance standards to 95%. Ofgem considers that the percentage targets and scope of the activities covered by this licence condition incentivises DN to deliver connections standards of service that can be reasonably expected by consumers and which DNs can reasonably be expected to be able to achieve. The licence condition and the amended regulations will provide incentives for gas transporters to provide reasonable connection services to end customers and

other customer groups who currently rely on Transco for connection services i.e. shippers, suppliers, other gas transporters and independent connection providers.

- 5.312. A potential purchaser suggested that the proposed arrangements were unduly onerous on new DN owners. It is important to note in relation to all the proposed standards that jobs identified as complex or excluded will not be covered by the standards where DNs cannot reasonably be expected to perform within standard due to circumstances beyond their control. Ofgem considers that it is appropriate for the proposed standards to reflect the perceived split between the level of competence and time required to produce quotations < 275kWh and > 275kWh.
- 5.313. Furthermore, clarification has been added in the form of paragraph 8, that the obligations of this condition apply separately to each RDN.
- 5.314. Ofgem invites respondents' views on its proposals for Standard Special Condition D10. The drafting for this condition is provided for comment in Appendix 8D.
- 5.315. Ofgem invites respondents' views on its proposals for Standard Special Condition D10. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

## ***Standard Special Condition D11: Charging obligations***

### **Reasons for licence condition**

- 5.316. As discussed in Chapters 3 and 4 regarding Amended Standard Condition 4 and 4A, and in the section for Special Condition C5 (Licensee's Procurement and Use of System Management Services) above, the charging obligations consulted upon within the next steps document, as represented by Standard Special Conditions A4 (Charging – General) and A5 (Obligation as Regard Charging Methodology), were drafted on the assumption that the charge change

provisions would be common across NTS and DN-GTs with changes to charges on a twice yearly basis.

5.317. However, following the publication of the next steps document, Ofgem's understanding of the revenue flows between the NTS, the DNs and shippers has changed. As a result, Ofgem has decided, on the assumption that only NTS exit capacity and NTS exit flow flexibility related charges will be passed through DNs to shippers, that it is no longer appropriate for these charge change obligations to be common.

5.318. As such, Ofgem has modified its proposals such that:

- ◆ the NTS-GT will be obliged to use its reasonable endeavours to announce changes to charges for flow flexibility and exit capacity once per year (on 1 October);
- ◆ the NTS-GT will be obliged to use its reasonable endeavours to announce changes to all other transportation charges twice a year (1 October and 1 April); and
- ◆ DN-GTs will be obliged to use its reasonable endeavours to announce changes to transportation charges once per year (on 1 October).

5.319. Respondents' views on the above have been summarised in the appropriate sections of Chapters 3 and 4. No detailed drafting comments have been received from DISG members with respect to this Standard Special Condition

### **Ofgem's proposals**

5.320. Given that these obligations now differ between the NTS and the DNs, it has been necessary to create two new conditions: an NTS Special Condition and a Standard Special Condition applicable to all DNs, such that the provisions of Standard Special Conditions A4 and A5 can be amended appropriately to reflect these differences. Standard Special Condition D5 sets out an obligation on DN-GTs to use reasonable endeavours to make changes to transportation charges once per year (on 1 October).

5.321. However, Ofgem would note that further modification of this condition may be required should the outcome of Transco's proposed pricing consultation result in



further charges being passed through DNs from the NTS to shippers. Should such changes be required, these will be made as part of a section 23 licence modification process subsequent to hive-down.

- 5.322. As noted in Chapter 3, as well as introducing the different charge change obligations, Standard Special Condition D11 clarifies that the provisions of Standard Special Condition A4 are applicable to each distribution network within Transco's RDN business.
- 5.323. Ofgem invites respondents' views on its proposals for Standard Special Condition D11. The drafting for this condition is provided for comment in Appendix 8D.
- 5.324. Ofgem invites respondents' views on its proposals for Standard Special Condition D11. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **RDN Special Conditions**

#### ***Special Condition E10: Separation of NTS and Distribution Network Businesses***

##### **Next steps document**

- 5.325. In the next steps document, Ofgem stated that conditions would be introduced as special conditions in Transco's NTS licence and a special condition in Transco's RDN licence requiring each RDN to use its reasonable endeavours to comply with the statement produced by the NTS pursuant to its licence obligations.

## **Respondents' views**

### *DISG comments*

5.326. Ofgem took the initial drafting of Special Condition E10 to DISG 30 and invited comments from DISG members. Industry participants have therefore had the opportunity to provide detailed comments on this drafting both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.

5.327. The drafting of this condition required the licensee to:

- ◆ use its best endeavours to comply with the statement produced by the NTS under Special Condition C20 (Segmentation of NTS and Distribution Network Businesses) (discussed earlier in this chapter). This was initially reasonable endeavours but has been changed in response to comments raised by potential purchasers at DISG that a best endeavours obligation should apply;
- ◆ establish separate managerial boards for each of the associated gas transporter businesses and the transportation business in respect of the NTS as part of the requirements needed to ensure managerial and operational independence of the associated gas transporter from any NTS operator; and
- ◆ appoint a business separation compliance officer for the purpose of facilitating compliance with this licence condition.

5.328. NGT stated that the inclusion of the “best endeavours” obligation was excessive and inappropriate. NGT stated that it would be perverse to apply a standard to an area of activity that carries lower risk and consequence than other areas (e.g. monopoly / competitive business separation).

5.329. A potential purchaser considered that the use of the term “managerial boards” within the condition could be confusing. This potential purchaser stated that if the “managerial boards” are not required to be boards in the corporate sense, it may be better to recognise that by calling them “managerial committees” or “managerial executives” thus keeping the word “board” to mean the board of directors of Transco plc.

5.330. A potential purchaser also stated that given the importance of the statement in ensuring separation of the NTS and RDN's there should be an absolute obligation, or at least a bests endeavours obligation on Transco to comply with this licence condition.

### **Ofgem's proposals**

5.331. Special Condition E10 in Transco's RDN licence requires, amongst other things, the licensee to ensure compliance with the terms of the statement prepared in accordance with NTS Special Condition C20.

5.332. Special Condition E10 also requires the licensee to put in place and maintain managerial and operational independence (including the establishment of separate managerial boards) to ensure that the licensee complies with the obligations of Standard Special Condition A6 (Conduct of the Transportation Business) and Standard Special Condition A35 (Prohibition of Cross Subsidies).

5.333. Ofgem agree with comments from shippers/suppliers that the industry needs to be confident that arrangements have been successfully implemented in relation to this licence condition. Ofgem will be consulting on Transco's proposals to comply with its obligations under this licence condition through DISG. If Ofgem is unsatisfied with Transco's proposals then Ofgem will consider further modifications as part of the section 23 processes planned for May.

5.334. Following consideration of respondents' views, the drafting of Special Condition E10 as presented at DISG 30 has been subject to certain modifications, including, but not limited to, the following:

- ◆ changing "all reasonable measures" to "best endeavours" in paragraph 1; and
- ◆ clarification of the drafting of paragraph 2 such that "at least two" members of the managerial boards shall be directors of Transco plc.

5.335. Both of these modifications are consistent with the changes proposed to Special Condition C20.

5.336. Ofgem invites respondents' views on its proposals for Special Condition E10. The drafting for this condition is provided for comment in Appendix 8E (1).

- 5.337. Ofgem invites respondents' views on its proposals for Special Condition E10. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **IDN Special Conditions**

#### ***Special Condition E11: Amendment to Credit Rating of the Licensee***

##### **Reasons for licence condition**

- 5.338. This licence condition was not consulted on as part of the next steps document. However, it has been decided, following discussions with Transco, that it would be appropriate to introduce a special condition that would apply to the licences of the four DNs that Transco is proposing to sell for the period between hive-down and share sale to address the fact that the four legally separate entities within which these licences will sit will not have their own credit ratings during this period.
- 5.339. This new special condition (Special Condition E11) will “augment” paragraph 1 of Standard Special Condition A38 (Credit Rating of the Licensee) such that the Authority is able to give prior permission to any such arrangements that the Authority considers appropriate as an alternative to the obligation to take all appropriate steps to maintain an investment grade credit rating. The drafting of this condition includes a sunset clause such that the condition ceases to have effect upon share sale.
- 5.340. The Authority proposes to issue “keep well” agreements to Transco to address the fact that credit ratings will not be in place between hive-down and share sale to coincide with this condition coming into effect.

- 5.341. Ofgem invites respondents' views on its proposals for Special Condition E11. The drafting for this condition is provided for comment in Appendices 8E (2), 8E (3), 8E (4), and 8E (5).
- 5.342. Ofgem invites respondents' views on its proposals for Special Condition E11. Ofgem notes that, following consideration of respondents' views, further licence modifications may be proposed as part of an additional section 23 process, which is planned for May 2005. Nothing in this consultation document shall fetter the discretion of the Authority with respect to enforcement of the conditions associated with the Authority's consent to hive-down or any subsequent consent granted by the Authority to share sale.

### **New Conditions no longer proposed**

- 5.343. In this section, we briefly explain why Ofgem is no longer proposing new conditions in the following areas:

- ◆ common system obligation;
- ◆ conduct of the transportation business in respect of the NTS;
- ◆ adjustments to the de minimis cap to take account of SOMSAs;
- ◆ governance of technical standards; and
- ◆ arrangements for gas measurement.

- 5.344. We consider each of these in turn below.

### ***Common system obligation***

#### **Next steps document**

- 5.345. As set out in Chapter 3 and earlier in this chapter, in the next steps document, a new licence condition relating to common system obligations was consulted upon. The drafting of this condition required all NTS and DN-GTs to ensure that the same systems and processes were in place for the implementation and administration of their network codes and enter into a CSA Agreement. This condition also provided for such systems to be economical and efficient, for the

costs to be established on an activity cost basis, and for all costs to be allocated on a transparent basis between relevant gas transporters.

### **Ofgem's proposals**

- 5.346. As discussed earlier in this chapter, in relation to Standard Special Condition A15 (Agency), following consideration of respondents' views, the provisions of the Common Systems Obligation, as presented in the next steps document, have been merged into those of the Agency condition.

### ***Conduct of the transportation business in respect of the NTS***

#### **Next steps document**

- 5.347. The licence drafting appended to the next steps document, included drafting for Special Condition C18 (Conduct of the transportation business in respect of the NTS). This NTS special condition augmented the provisions of Standard Special Condition A6 (Conduct of the Transportation Business) to prevent the NTS from conferring unfair commercial advantages on its RDNs.

### **Ofgem's proposals**

- 5.348. As discussed in Chapter 4, following consideration of respondents' views with respect to Standard Special Condition A6, and following discussions at DISG, Ofgem decided that it would be more appropriate to provide the necessary clarifications with respect to the separation of Transco's NTS and RDN businesses within paragraph 1(a) of Standard Special Condition A6. As such, Special Condition C18 is no longer proposed.

### ***Adjustments to the de minimis cap***

#### **Next steps document**

- 5.349. As set out in Chapter 3, in the next steps document, Ofgem stated that, a new licence condition would be required to augment the provisions in Standard Special Condition A36 (Restriction on Activity and Financial Ring-Fencing) to raise the cap on de minimis businesses for the RDN GT licence so that it could accommodate income from new services agreements such as SOMSAs. Ofgem

therefore proposed to introduce a licence condition into the RDN GT licence augmenting Standard Special Condition A36.

### **Respondents' views**

- 5.350. The views of respondents regarding whether SOMSAs should be regulated are provided in Chapter 3. The views of respondents relating to the drafting of the proposed special condition are summarised below.

#### *NGT*

- 5.351. NGT suggested that 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), 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, NGT considered it more appropriate to define this through a "maximum revenue" level and to exclude the investment level criteria. NGT suggested that 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, NGT suggested that there is currently no meaningful investment denominator since share capital, premia and consolidated reserves exist at Transco plc level rather than GT business level.

#### *Potential purchasers*

- 5.352. One potential purchaser accepted the need to relax the relevant constraints within appropriate conditions and the applicability and the wording of the special condition as drafted.
- 5.353. Another potential purchaser noted Ofgem's proposals and suggested that it may also be necessary for an equivalent special condition to be introduced for the IDNs since they will be offering services to NGT's RDNs.

#### *Shippers/suppliers*

- 5.354. One shipper/supplier considered that SOMSAs are likely to persist for much longer than 18 months and this in fact may well prove to be desirable as it may

help reduce the motivation of new DN owners to seek to fragment the arrangements inefficiently. This respondent suggested that the lack of transparency and regulatory scrutiny of these documents may raise concerns as to the potential scope for discrimination between DNs. This shipper/supplier stated that they would prefer to see the standard form SOMSA terms defined as an integral part of the offtake arrangements. Alternatively, this respondent proposed introducing a licence condition effectively regulating these documents beyond the start date of the next price control.

5.355. Another shipper/supplier agreed with Ofgem that since system operation services are commercial agreements these should not be regulated, although consideration should be given to those areas where there is potential for adverse impacts on customers, such as safety and emergency response. This shipper/supplier suggested that the introduction of a time limited obligation to provide services on a non-discriminatory basis is appropriate.

5.356. One shipper/supplier preferred the SOMSA to be subject to regulatory scrutiny to provide the market confidence that these proposed bilateral agreements will not discriminate between DNs and ultimately impact the quality of service delivery to shippers and customers. In addition this shipper/supplier respondent recommended that the standard form of these documents be incorporated into the Offtake agreements.

#### *DISG comments*

5.357. There has been discussion of the proposed de minimis services at a number of DISG meetings since publication of the next steps document (including DISG 31 and DISG 32). Industry participants have therefore had the opportunity to provide detailed comments on this issue both during these meetings and by written responses after these meetings. The minutes of these meetings are included in Appendix 2.

5.358. Following discussions with NGT and at DISG it has become clear that there will be a number of service agreements between the NTS, the RDN business, and the IDNs that would require extensions to the de minimis caps of each licensee for varying lengths of time.



- 5.359. A potential purchaser welcomed the discussion and the recognition of the need to consider the correct handling of the revenue received by IDNs in respect of the provision of services from the IDNs to the NTS. This potential purchaser also supported the proposal put forward at DISG, whereby the licence condition would make reference to the services that can be provided and excluded from the de minimis provisions. However, this potential purchaser did not consider that it was necessary to include an upper limit on the revenue that would be obtained within the licence condition. This potential purchaser suggested that, as an alternative, it may be simpler for Ofgem to specify that all of the revenue obtained under the new contracts put in place as part of the sale for services to/from the IDNs, RDNs and NTS, could be treated as excluded revenue for the purposes of calculating the de-minimis limit under the ring-fence. This would mean that the existing 2.5% limit could be retained. However, this potential purchaser did recognise that some form of reporting to Ofgem on these services and the relevant amounts excluded from the de minimis provisions on an annual basis would be required.
- 5.360. The same potential purchaser also raised a concern regarding the relative amounts paid under the Network Service Agreements (NSAs) by IDNs compared to RDNs. This respondent considered that it would be vital to normalise the underlying data at the next price control review to address any differential in the charges for these services. Otherwise, the comparison of relative efficiency would be distorted.
- 5.361. A shipper/supplier also expressed concern that there were noticeable differences in the magnitude of costs of services provided to or by IDNs compared to RDNs. This shipper/supplier stated that, although there may be perfectly legitimate reasons for these differences, it would be helpful for an explanation of the differences in magnitude to be put forward.
- 5.362. This shipper/supplier also considered that it was not appropriate that any revenue IDNs paid to the NTS in respect of competitive meter work and on behalf of suppliers and other parties, should be included within any de minimis provision made for DN sales.
- 5.363. The same shipper/supplier stated that it would be happy for the licence condition to reference services that can be included and excluded from the

current de minimis limit as a result of DN sales subject to an upper limit and the exclusion of any revenues associated with Onstream.

### **Ofgem's proposals**

- 5.364. Ofgem now believes that it is necessary to undertake a thorough review of the services and revenue flows under the terms of such agreements. Given the number and complexity of such arrangements, Ofgem proposes that, rather than specifying the revenues and duration of such agreements in the licence, it would be more appropriate to exclude such services from the definition of de minimis business. Ofgem believes that the exclusion of such services from the definition of de minimis business should be for the duration of such agreements or the duration of the current price control period, whichever is shorter, and that provisions should be imposed that require transparency of the services provided and associated revenues within the regulatory accounts condition.
- 5.365. As such, a new licence condition is no longer proposed in this regard. Instead, Ofgem will undertake a full review of such services and revenues before issuing consent to these services under paragraph 3(d) of Standard Special Condition A36 (Restriction on Activity and Financial Ring-Fencing).

## ***Governance of technical standards***

### **Next steps document**

- 5.366. In the next steps document Ofgem outlined that it was minded to introduce a new licence condition relating to the technical specifications and operational procedures for making connections to networks. Ofgem stated that it believed that there was a need for a draft licence condition to ensure uniformity in respect of the technical standards imposed by DNs without hindering innovation in connections and/or interfering with the provisions of the DN safety case.

### **Respondents' views**

*NGT*

- 5.367. NGT did not comment on this proposal.

### *Potential purchasers*

- 5.368. All potential purchasers stated that they did not consider it appropriate to introduce a licence requirement concerning the governance of technical standards and stated that such standards should be contained in specific industry codes rather than the licence. One potential purchaser suggested that industry standards already existed and to fetter DNs with a specific standard, that might be different from a developed industry standard, would reduce the ability for innovation and thus lead to higher transportation costs. This potential purchaser also suggests that the possibility of different standards arising already exists today as between IGTs and DNs so this issue should not be addressed as part of the sales process.
- 5.369. One potential purchaser stated that industry codes of practice would not preclude regulatory oversight since Ofgem would have the ability through licensee's obligations not to restrict, distort or prevent competition as well as the possibility of Competition Act action. This potential purchaser also believed that this approach would not preclude introducing specific licence obligations at a later date if so required.

### *Shippers/suppliers*

- 5.370. No shippers/suppliers commented on this proposal.

### **Ofgem's proposals**

- 5.371. Having considered respondents' views on this issue Ofgem has concluded that at this time it is not necessary to introduce a licence condition. Ofgem believes that it is appropriate for an industry forum to discuss the possibility of introducing a technical / governance framework. Ofgem believes that this would encourage transparency in relation to technical standards and operational procedures. Such a framework could be similar to arrangements which presently exist in the electricity connections industry where the Energy Networks Association (ENA) maintains the G81 technical specifications document, which outlines the technical requirements for each electricity distribution network operator in relation to connections. Changes to G81 are currently considered and approved by the Ofgem chaired Electricity Connections Steering Group.

- 5.372. As an interim arrangement Transco presently produces a 'Transco Connections Policy manual', which outlines the technical standards which need to be complied with when connecting to the Transco network. It is Ofgem's understanding that the new DNs will also be using a copy of this manual. In addition, the IGTs also have a connections policy when connecting onto their networks.
- 5.373. Ofgem will take these issues forward through an appropriate industry forum and consider how to establish an appropriate governance mechanism to ensure that changes in technical requirements are, where appropriate, consulted upon prior to introduction.

## ***New arrangements for gas measurement***

### **Next steps document**

- 5.374. In the next steps document Ofgem outlined that it was minded to require Transco to formalise the informal arrangements that are currently in place for testing flow measuring equipment within the UNC. In relation to the informal arrangements for testing for water vapour issues, Ofgem stated that as it was consulting on discontinuing the informal arrangements it was inappropriate to consider a new licence condition at this time.

### **Respondents' views**

- 5.375. NGT and shippers/suppliers expressed no views on this issue.
- 5.376. One potential purchaser agreed that the present arrangements regarding the testing of measuring equipment should be formalised. This potential purchaser considered that such arrangements should be in a specific industry code rather than the UNC, as the latter is essentially a commercial contract. This potential purchaser also agreed that the present arrangements for the testing of water vapour should be discontinued.
- 5.377. Another potential purchaser supported the approach that would formalise arrangements for testing measuring equipment within the UNC rather than via the licensing route. A third potential purchaser suggested that the arrangements for testing measuring equipment should be dealt with in the NTS/DN operator

agreement since that is the most appropriate place for dealing with the practical arrangements associated with the testing of measuring equipment. This potential purchaser also agreed with the proposal for the present arrangements for the testing of water vapour to be discontinued.

### **Ofgem's proposals**

- 5.378. Ofgem continues to believe that the testing of equipment for measuring gas flows between the NTS and DNs should reside within the UNC.
- 5.379. Ofgem, through its appointed Gas Examiners, anticipates continuance of its current activities relating to calorific value measuring equipment directed by the Authority under the Gas (Calculation of Thermal Energy) Regulation 1996.
- 5.380. Ofgem believes that as it has proposed to discontinue the informal wet gas administration scheme<sup>54</sup> there is no further requirement for there to be a licence condition formalising these arrangements.

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<sup>54</sup> Gas Quality: Wet Gas Administration Scheme Final Proposals December 2004

## 6. Way forward

- 6.1. This chapter sets out the way forward with respect to the licence modification process and the implementation of the proposed sales transaction.

### ***Section 8AA and related section 23 consultation***

- 6.2. As described previously, this document attaches a formal section 8AA Notice under the Gas Act proposing the modification and transfer of four of Transco's six GT licences (in respect of the four IDNs) to four wholly-owned subsidiary companies. It is intended that the shares in these subsidiary companies will (subsequent to the transfer of the four relevant GT licences and hive-down of the four DNs) be sold to third party purchasers.
- 6.3. In addition, the document attaches a formal Notice under section 23 of the Gas Act proposing the modification of the two remaining Transco GT licences in respect of Transco's NTS and retained DN businesses.
- 6.4. Ofgem welcomes respondents' views, including the views of potential DN purchasers and other interested parties, on both the section 8AA and the section 23 Notices to be received by close of business on 15 April 2005.<sup>55</sup>

### ***Related consultation on Uniform Network Code***

- 6.5. In addition to undertaking these licence modifications and related transfers, in March 2005 Ofgem intends to conduct an informal consultation on the proposed legal text of the UNC. This will be an important consultation that will enable Ofgem to consider representations from industry participants on the proposed UNC arrangements when it determines whether to direct the proposed modification to Transco's existing network code to create a short form code that incorporates the UNC by reference. It is expected that Transco will issue this

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<sup>55</sup> It is noted that in August 2004 Ofgem wrote to the proposed purchasers of the DN businesses encouraging them to respond and comment upon the proposed licence modifications. This letter can be found on Ofgem's website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Ofgem has to this point received valuable input from potential purchasers as part of previous licence consultations and would encourage purchasers to comment on the modification proposals attached to this document.

modification proposal for consultation in March 2005 at the same time as Ofgem consults on the UNC.

## ***Decisions on licence and code***

- 6.6. Subject to consideration of respondents' views to the section 8AA and section 23 licence consultations, as well as respondents' views to the Ofgem UNC consultation and the expected Transco network code modification proposal, Ofgem is proposing to issue decisions on the licence modifications (and related licence transfers) and Transco's network code modification proposal on 25 April 2005.
- 6.7. It is important to note that it is possible that respondents to the consultations may raise issues that prevent Ofgem reaching decisions on the licence and network code on this date. For example, concerns may be raised regarding the terms of the UNC which lead Ofgem to conclude that Transco's modification proposal does not better facilitate the relevant objectives of its network code as set out in Amended Standard Condition 9 of its original GT licence. In this event, it may be necessary for Transco to consult further upon its UNC proposals thus delaying the hive-down of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies and the subsequent sales transaction.
- 6.8. However, on the assumption that no such issues are raised, and assuming that Transco consents to the licence modification proposals, it is envisaged that the licence modifications (and licence transfers) will be directed for implementation on 1 May 2005, the scheduled date for hive-down and transfer of the four relevant GT licences, subject to Transco meeting all of the relevant conditions precedent to the Authority's consent which was granted on 20 January 2005.<sup>56</sup>

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<sup>56</sup> It is noted that as part of the conditions that were attached to the Authority's consent on 20 January, Transco's consent to the modifications to its six GT licences proposed through the section 8AA and related section 23 processes is required before it can hive-down its DN assets into its four wholly owned subsidiary companies. Further information on the conditions to consent can be found in the Authority's decision document on DN sales, namely, *National Grid Transco – Sale of gas distribution network: Transco plc applications to dispose of four gas distribution networks*, Ofgem, February 2005.

## ***Process following hive-down and transfer***

- 6.9. In May 2005, Ofgem intends to issue a further section 23 Notice to modify the two licences which will at that stage be held by Transco in respect of the NTS and the RDNs and each of the four licences which will at stage be held respectively by the four wholly owned subsidiary companies in respect of the IDNs. The purpose of this notice will be, amongst other things and without limitation, to propose the introduction of interim incentive arrangements on Transco's NTS business and each of the DNs that in Ofgem's view are necessary to protect the interests of customers within a divested industry structure. In addition, the May section 23 Notice may be required to propose changes to each of the six GT licences to capture issues raised during the previous licence consultations that were not anticipated at the time and which need to be addressed. The May 2005 licence modification proposals will be formally consulted upon over a 28 day period.
- 6.10. It is important to note that as part of the Authority's conditions to consent as granted on 20 January 2005, Transco would not be able to sell the shares in the four relevant wholly owned subsidiary companies without the Authority's prior consent. In addition, the Authority's conditions to consent also provide that Transco and each of the four relevant wholly-owned subsidiary companies shall consent to any licence modifications and implement any other regulatory, commercial or operational changes following hive-down that the Authority considers are necessary in order to ensure that the proposed sales transactions are implemented in a manner that ensures that the interests of customers are protected. Until these conditions are met the Authority will not provide its consent to the share sale occurring.
- 6.11. As such, and having considered respondents' views to the licence consultation, Ofgem would not be in a position to consent to the share sale until such time as Transco and each of the four relevant wholly owned subsidiary companies have provided their consent to the May 2005 section 23 licence modifications. Once these consents are forthcoming the Authority would subsequently direct the licence modifications.
- 6.12. Provided that the Authority is satisfied that the regulatory, commercial and operational arrangements are sufficient to protect the interests of customers



within a divested industry structure and that no further changes to these arrangements are necessary at that time, the Authority would then proceed to provide its consent to the share sale, thereby allowing the sales transaction to complete. It should be noted that the Authority could, if necessary to protect the interests of customers, attach conditions to any such consent.

### ***Process following completion***

- 6.13. As noted previously, as part of the section 8AA and section 23 consultations attached to this document, the Authority is proposing the introduction of a number of licence conditions on Transco and each DN requiring them to use best endeavours to implement the enduring offtake arrangements by 1 September 2005.<sup>57</sup> It is expected that these arrangements would be introduced via modifications to the UNC.
- 6.14. Following the completion of the share sale, the Authority is therefore expecting to consider UNC modification proposals relating to the introduction of the enduring offtake arrangements, including the enduring arrangements for the allocation of NTS exit capacity and NTS offtake flow flexibility.
- 6.15. As part of this process, Ofgem also intends to bring forward licence modifications to each of the six GT licences in July 2005 to, amongst other things and without limitation, introduce enduring incentive arrangements on Transco's NTS and RDN businesses as well as the IDNs for implementation by September 2005. These incentive arrangements are intended to support the introduction of the enduring offtake arrangements and will be consulted upon through the formal licence modification process set out in section 23 of the Gas Act.

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<sup>57</sup> The enduring offtake arrangements are described in chapter 5 of Ofgem's Final Impact Assessment on DN sales, namely, *National Grid Transco, Potential sale of gas distribution network businesses, Final Impact Assessment*, Ofgem, November 2004.