

Transco, Shippers and other  
interested parties

29 March 2005

Dear Colleague,

## **Gas distribution network sales - Stage 2 of consultation on the network code arrangements**

### **Background**

On 4 March 2005, Ofgem issued its consultation on the network code arrangements that would be put in place to support a divested industry structure following a potential sale of gas distribution networks (the 'network code consultation document').<sup>1</sup> This is the document referred to in paragraph 3.172 of the Authority's decision in relation to Transco plc's (Transco) application to dispose of four gas distribution networks (DNs).<sup>2</sup> The purpose of the network code consultation was to give interested parties the opportunity to comment on the Uniform Network Code (UNC), as drafted by Transco following a period of extensive consultation with shippers and potential DN purchasers as well as providing them with an opportunity to comment in the round on all aspects of the Authority's decision in relation to the network code arrangements, including without limitation:

- ◆ Transco's Modification Proposal 0745, which proposes to modify Transco's Network Code into an individual ('short form') network code that incorporates by reference the UNC;<sup>3</sup> and
- ◆ the proposed Gas Transporter (GT) licence conditions which support this, specifically, Standard Special Conditions A11, A12 and A15.<sup>4</sup>

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<sup>1</sup> *Gas distribution network sales – consultation on the network code arrangements*, Ofgem, 4 March 2005, 73/05.

<sup>2</sup> *National Grid Transco – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks*, Decision document Ofgem, February 2005 21/05, pg 78.

<sup>3</sup> Transco submitted Urgent Modification Proposal 0745 to Ofgem on 23 February 2005. Ofgem granted urgency status on 25 February 2005. Urgent Modification Proposal 0745 is currently being progressed in accordance with Transco's Network Code modification rules, using a parallel but separate process to this consultation process.

<sup>4</sup> *National Grid Transco – Potential sale of gas distribution network businesses, Formal consultation under section 23 and section 8AA of the Gas Act 1986*, Ofgem, February 2005, 45/05.

The network code consultation document explained that Ofgem had decided to adopt a five week consultation process that was split into two stages to allow for an additional iteration of respondents' views to be incorporated into the draft UNC. This process is explained in more detail later in this letter.

This consultation represents the final stage in an extensive consultation process which has included Regulatory Impact Assessments (RIAs), industry participation via the Development and Implementation Steering Group (DISG), and Transco's own UNC development process. The process will culminate in the Authority's decision, scheduled to be taken in late April, on DN sales generally, including the proposed licence modifications and Urgent Modification Proposal 0745.

In accordance with the process described in the network code consultation document, responses were received by Ofgem and Transco in relation to Stage 1 of the consultation on 18 March 2005. Twelve responses were received from shippers, potential DN purchasers, and another interested party.<sup>5</sup> Ofgem would like to thank those parties that offered comments at this time.

### **Respective roles of Transco and the Authority**

As explained in the network code consultation document, Transco is responsible for preparing the UNC and, as such, is responsible for assessing respondents' views and proposing revisions to the original draft of the UNC, issued for consultation on 4 March 2005, based on those comments. The Authority's role is to decide, having regard to its principal objective and other statutory obligations, whether the conditions, as set out in the Authority decision document, have been met in order to allow Transco to hive-down the assets of four DNs into wholly-owned Transco subsidiaries and whether it is appropriate (having regard to respondent's views) to:

- ◆ modify Transco's 6 GT licences as set out in the section 23 and section 8AA notices published on 14 February 2005<sup>6</sup>; and
- ◆ direct that the Network Code be modified as proposed in Urgent Modification Proposal 0745.

It is important to be clear that nothing in this letter fetters the discretion of the Authority in relation to DN sales, including without limitation, any decisions in respect of:

- ◆ the proposed licence modifications currently being consulted upon;
- ◆ Urgent Modification Proposal 0745;
- ◆ the proposed UNC; and/or
- ◆ the various 'short form' network codes.

Further, in publishing Transco's draft UNC and related documents for consultation, it is important to note that the Authority takes no responsibility for the accuracy or completeness of

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<sup>5</sup> Respondents are listed in Attachment 1 and responses are published on Ofgem's website.

<sup>6</sup> *National Grid Transco – Potential sale of gas distribution network businesses, Formal consultation under section 23 and section 8AA of the Gas Act 1986*, Ofgem, February 2005, 45/05.

the documents and, in particular, gives no assurance that all modifications which have been directed by the Authority have been incorporated by Transco into the draft UNC.

The Authority is not to be construed as endorsing or in any way designating the document (including for the avoidance of doubt the 'short form' network code envisaged by Urgent Modification Proposal 0745), and there can be no expectation on the part of Transco, potential DN purchasers, or any other interested party as to the final decision by the Authority in relation to Urgent Modification Proposal 0745 and/or any of the other decisions referred to in the previous paragraphs.

### **Weeks 3 & 4 of the network code consultation**

Attached to this letter for further comment are the following documents, which have been prepared by Transco:

- ◆ a revised draft of the UNC;
- ◆ revised drafts of the Agency Services Agreement, Joint Governance Arrangements Agreement and the Incremental Exit Capacity Statements;
- ◆ a set of tables that sets out Transco's response to each issue raised in Stage 1 responses; and
- ◆ an updated drafting changes guide.

In order to aid parties that wish to respond during the final two weeks of the five week consultation period, Transco has provided these documents in a number of formats: clean; marked up relative to the draft UNC circulated on 4 March 2005, and; marked up relative to version 3.09 of the current network code (cumulative mark up). In addition, UNC constituent documents with multiple sections have been provided on a consolidated basis and by individual section.

Consistent with the letter of 4 March 2005, Ofgem invites comments on the original text of the UNC, issued for consultation on 4 March 2005, together with comments on the revisions to that document, proposed by Transco today, on these drafts by 12 April 2005.

In addition, Ofgem considered that it would be helpful to respond to certain points set out in responses to Stage 1 of this five week consultation in relation to the process that has been followed by Ofgem.<sup>7</sup> Some respondents, in particular potential DN purchasers, considered that the UNC development process had given them sufficient opportunity to address their issues. However, other respondents raised concerns regarding the process, which Ofgem considers it appropriate to address.

### **Ofgem response in relation to process issues**

Ofgem has explained, earlier in this letter, the respective roles of Transco and the Authority. Consistent with that, it is a matter for Transco to decide, having regard to its statutory and

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<sup>7</sup> Ofgem does not make any comment regarding respondents' comments relating to the process followed by Transco.

licence obligations, how to address the UNC related issues raised by respondents in response to Stage 1 of this five week consultation. However, Ofgem would like to respond to certain points made by respondents in relation to Ofgem's role, in particular:

- ◆ the duration of the consultation period;
- ◆ the purpose of the network code consultation document;
- ◆ whether the Authority has fettered its discretion in relation to its decision on the network code arrangements; and
- ◆ the scope of changes required to give effect to DN sales.

This letter does not address views expressed in relation to the process that Transco has adopted in developing the draft UNC as it is for Transco to set out its position on these issues.

#### *Duration of the consultation period*

Whilst potential DN purchasers considered that the UNC development process had given them sufficient opportunity to address their concerns, some respondents considered that two weeks was not a reasonable interval between the release of the network code consultation document and the deadline for Stage 1 submissions. It was also suggested that the Authority decision document<sup>8</sup> gave rise to an expectation that the Stage 1 consultation period would be at least four weeks. Having considered respondents views, Ofgem does not agree with these views for the reasons set out below.

First, it is important to be clear that this is a consultation over a five week period on the document issued by the Authority on 4 March 2005. As part of this five week process, there was an opportunity for respondents to make comments on the draft at the end of week two and for Transco to consider those comments and update the original draft in week three having regard to respondents' views. Those changes to the original consultation draft can then be considered (together with the original draft) by respondents in the final two weeks of the consultation.

This two stage consultation process was intended to give interested parties the opportunity to provide an additional round of comments on the UNC and to provide an opportunity to comment in the round on a number of related issues. Conducting the consultation in this way ensures that respondents have an opportunity to raise issues on the drafting and to help shape the documentation.

In addition, notwithstanding that the draft UNC is a Transco document, Ofgem chose to conduct a consultation on this issue, and this form of consultation in particular, to allow an opportunity for respondents to make the Authority aware of their views in the round. As such, Ofgem does not consider that respondents' ability to contribute to this process has in any way been restricted and considers that this form of consultation should be regarded as an enhancement rather than a limitation of the consultation process. Interested parties are (and were) free to submit responses only at Stage 2 of the consultation process (weeks four and five of the process) and indeed many respondents have indicated that they may identify new issues during the second round of consultation.

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<sup>8</sup> *National Grid Transco – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks, Decision document Ofgem, February 2005 21/05.* The relevant paragraph appears on pg 78.

Second, Ofgem does not agree that the Authority decision document gave rise to an expectation of at least a four week period for consultation. No time period was specified. As explained above, the process involves consultation over a five week period and the network code consultation document was released at the end of an extensive consultation process conducted by Ofgem and Transco.

As respondents will be aware, Ofgem's consultation policy explicitly sets out that Ofgem may elect to shorten its timetable if the consultation relates to a project that has already been the subject of extensive consultation.<sup>9</sup> We consider that the UNC development process is a clear example of a project which has been subject to extensive consultation for the following reasons:

- ◆ the high level regulatory and commercial framework was consulted upon in a series of four RIAs, which culminated in the publication of a Final Impact Assessment in November 2004;<sup>10</sup>
- ◆ key areas of change required to protect the interests of customers in the event of a sale have been extensively discussed at the DISG, which has been open to all industry participants to attend;<sup>11</sup> and
- ◆ over the period since September 2004 Transco has conducted its own consultation process in relation to the detailed development of the UNC, which has included the establishment a number of development and legal drafting workgroups and the publication of a consultation document in relation to Transco's proposed business rules to apply to each section of the UNC.

This work is described in the network code consultation document. Further, Ofgem explained at DISG 36 that it would conduct the consultation on this basis to ensure interested parties had a full opportunity to be involved in this process.

As such, Ofgem considers that, given the extensive consultation process which took place prior to the commencement of the network code arrangements consultation on 4 March as well as the commercial nature of the transaction, a five week timetable associated with the network code consultation document is reasonable and appropriate in the circumstances.

#### *Purpose of the network code consultation document*

Some respondents questioned whether the network code consultation document was the document referred to in the Authority decision document. Ofgem considers it is clear that this is the case. The network code consultation document explains the background to the publication of the document, including the Authority's conditional consent. Further, the document was published in accordance with Transco's timetable for the release of the Ofgem UNC consultation document<sup>12</sup>, and the nature and purpose of the document was explained by Ofgem at DISG 36.<sup>13</sup>

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<sup>9</sup> *Ofgem consultation policy*, Ofgem, June 2002, pg 6.

<sup>10</sup> *National Grid Transco - Potential sale of gas distribution network businesses Final Impact Assessment* Ofgem November 2004.

<sup>11</sup> The minutes and papers of the DISG and other workgroups are available on Ofgem's website.

<sup>12</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9939\\_DN\\_Sales\\_time\\_line.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9939_DN_Sales_time_line.pdf)

<sup>13</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10613\\_DISG36mins.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10613_DISG36mins.pdf)

### *Whether the Authority has fettered its discretion*

One respondent suggested that the Authority's discretion in respect of DN sales had been fettered. Ofgem rejects this suggestion. Throughout the consultation process, Ofgem has made it clear to all parties that nothing Ofgem says or does can fetter the discretion of the Authority in respect of any issue associated with DN sales.<sup>14</sup> The Authority will carefully consider responses to the network code arrangements consultation, the proposed licence modifications and Urgent Modification Proposal 0745 before making a substantive decision on whether or not its conditions precedent to hive-down<sup>15</sup> have been met and, more generally, in relation to DN sales.

### *Scope of changes required to give effect to DN sales*

Finally, it was suggested in responses that some aspects of the changes set out in Transco's draft UNC, specifically changes relating to the UNC modification process and the offtake arrangements, went beyond the changes required to give effect to DN sales. Ofgem does not intend to make any comment on the detailed drafting prepared by Transco as part of this process. However, as previously explained,<sup>16</sup> Ofgem considers that changes to the modification process and the offtake arrangements are required to protect the interests of customers under a divested industry structure. This view is shared by the Authority which, as part of its conditional decision, endorsed the need for these changes. It is now a matter for Transco to propose the arrangements which it considers, having regard to its statutory and licence obligations, better facilitate the relevant objectives in divested industry structure.

### **Views invited – Stage 2 of the UNC consultation process**

Consistent with the process described in the network code consultation document, a revised version of Transco's draft UNC has today been published on Ofgem's website. The revised draft UNC is accompanied by a set of tables (prepared by Transco) that sets out Transco's response to each issue raised in Stage 1 responses.

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<sup>14</sup> By way of example, this point has been made in the Ofgem position paper on UNC governance (*Ofgem preliminary position on the Uniform Network Code modification process & the constitution of the governance entity*, DISG 15, August 2004) through DISG meetings, in the open letters published on Ofgem's website on 4 February ([http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10080\\_20050203OpenlettertoChrisTrainregovernanceFINAL.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10080_20050203OpenlettertoChrisTrainregovernanceFINAL.pdf)) and 8 February ([http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10120\\_20040208\\_20050208MAletterreparticipationinUNCworkgroups.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10120_20040208_20050208MAletterreparticipationinUNCworkgroups.pdf)) and in a statement made at the UNC Legal Drafting Forum on 17 February. This list is not inclusive.

<sup>15</sup> These conditions are referred to as 'Phase 1' conditions in the Authority decision document.

<sup>16</sup> See, for instance, [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10613\\_DISG36mins.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10613_DISG36mins.pdf), and *National Grid Transco – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks*, Decision document Ofgem, February 2005 21/05, Chapter 3.

Ofgem welcomes the views of interested parties in relation to the UNC, published on 4 March 2005, together with the revisions proposed by Transco as part of Stage 2 of the network code consultation, including in relation to:

- ◆ the points made in this letter;
- ◆ Transco's revised drafting of the UNC;
- ◆ the revised related documents released by Transco, including the Agency Services Agreement, the Joint Governance Agreement, and the Incremental Exit Capacity Statement;
- ◆ proposed Gas Transporter Licence Standard Special Conditions A11, A12 and A15; and
- ◆ Network Code Urgent Modification Proposal 0745.

Interested parties are requested to provide comments by no later than 12 April 2005. Responses should be addressed to:

Sonia Brown  
Director, Transportation  
Office of Gas and Electricity Markets  
9 Millbank  
London SW1P 3GE  
(Telephone: 020 7901 7412)  
DNsalesgroup@ofgem.gov.uk

As explained in the network code consultation document, responses will inform, among other things, the Authority's decision in relation to Modification Proposal 0745 and the current section 8AA and section 23 licence consultations. As such, responses in respect of this stage of the process should be sent to Ofgem only (and not sent or copied to Transco).

Respondents are free to mark their reply as confidential, although we would prefer, as far as possible, open responses that can be placed in the Ofgem library. Ofgem would also prefer that non-confidential responses are sent electronically so that they can be placed on the Ofgem website.

If you wish to discuss any aspect of this paper, Jessica Hunt (telephone 020 7901 7431) or Hannah Cook (telephone 020 7901 7444) would be pleased to help.

Yours sincerely,

Sonia Brown  
**Director, Transportation**

## **Attachment 1 – Respondents to Stage 1 of the consultation on the network code arrangements**

BP

British Gas Trading

EDF Energy

Eon UK

Genserv

Macquarie Gas Networks

Npower

Scottish & Southern Energy

Shell

Statoil

Total Gas & Power

United Utilities/Cheung Kong Infrastructure