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Dear Sonia

Update on process regarding conditions precedent of the Authority's consent directions

This letter is provided in response to Ofgem's open letter of 13 April 2005 requesting an assessment of the extent to which each of the conditions precedent set out in the Authority consent to Network Sales issued in February 2005¹ have been met, and in our view, how this has been achieved. Our assessment in this respect is provided in **Appendix 1** to this letter.

In addition, in respect of paragraph 21(d) of the Authority's four consent directions, Ofgem have asked that we provide a summary of the responses to Stage 2 of Ofgem's consultation on network code arrangements, which closed on 12 April 2005, together with a table which sets out Transco's views on the issues raised in the responses received. We have been asked to identify any issues that we consider sufficiently material to warrant change to the documents and further consultation before hive-down can occur, and, separately, any issues which, whilst not being sufficiently material to merit change to the documents prior to hive-down, might be appropriate to address in the future. Ofgem have also asked that we provide a table of any typographical errors we have identified in the Uniform Network Code (UNC) and how we propose to address these.

Ofgem have also asked that we provide Ofgem with the UNC that Transco proposes to implement in the event that the Authority decides to allow hive-down, and an assessment of whether it is Transco's view that this version of the UNC is in a form which is sufficient to allow hive-down to proceed, and Transco's reasons for this assessment.

In response, **Appendix 2** provides our assessment of the UNC, the Agency Services Agreement (ASA) and the Joint Governance Arrangements Agreement (JGAA), taking account of Stage 2 responses to Ofgem's consultation on network code arrangements²,

¹ NGT – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks, Decision document Ofgem, February 2005 21/05, Appendix 2

² Ofgem Open Letter Gas Distribution Network Sales –consultation on Network Code Arrangements, March 2003 and 99/05 – Ofgem Open Letter Gas Distribution Network Sales - Stage 2 of consultation on the Network Code Arrangements.

(which we summarise in the Appendix). We set out why we believe that the UNC, the ASA, and the JGAA, which form the key building blocks to the new contractual framework, are now sufficiently robust to support a divested industry structure and the creation of four Transco DN subsidiaries as a precursor to the completion of the network sales process. The document entitled “UNC Stage 2 Response Matrix”, which accompanies this letter, addresses the specific issues raised by respondents and our response to each issue.

Taking account of responses to the second stage of the consultation, we have not identified any issues sufficiently material to warrant changing the UNC³ prior to hive-down. Furthermore, we have not identified any material issues at this stage which might in Transco’s opinion merit consideration in the future, other than to review the modification rules when there is clarity on how the DTi Appeal process will operate. However, this does not fetter the ability of any interested parties to utilise the UNC Modification Procedures following hive-down to address any residual concerns they may have, or to put forward modification proposals if they disagree with our assessment.

In respect of the ASA and JGAA³, five minor changes were identified by respondents to the consultation; four to the JGAA and one to the ASA. Transco will make these changes before these documents are signed, shortly in advance of hive-down.

Appendices 3 and 4 detail the changes, typographical and otherwise, that we consider need to be made to the UNC, JGAA, and ASA, and how we intend to promulgate each change. Five minor changes were identified by respondents to the consultation and are set out in **Appendix 3**; none relate to the UNC. The remaining changes (24 in total) were identified by Transco and are set out in **Appendix 4**; all relate to the UNC. In Transco’s opinion, all the proposed changes to the UNC are non-material corrections of typographical and cross-referencing errors, together with one deletion of redundant text erroneously included in the Stage 2 document, and in our view do not prejudice the suitability of the UNC for operation in a post sales environment. Accordingly, we intend to deal with the 24 corrections to the UNC by seeking Ofgem’s consent to modify the UNC under prospective Standard Special Licence Condition A11(13) immediately after hive-down.

Therefore, in terms of the UNC, having carefully considered respondents’ views in response to the second stage of Ofgem’s five-week consultation, and our own assessment of the document, we have not identified a requirement for any material changes at this stage. We therefore believe that the UNC that was published by Ofgem on 29 March 2005 and considered as part of Stage 2 of Ofgem’s consultation on network code arrangements is now sufficiently robust to allow hive-down to occur. We consider that the UNC in this form will enable all relevant prospective GT licensees (Transco NTS, Transco RDN, and each prospective IDN) to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their respective GT licences. Furthermore, we consider the UNC to be consistent with all relevant Authority decisions associated with network sales. Accordingly, we have provided this version⁴ to Ofgem as the Day 1 UNC as being appropriate to support a divested industry structure from the Appointed Day (anticipated to be 1 May 2005, in accordance with the published timetable). Clearly, if

³ References to the UNC, JGAA and ASA relate to the draft versions published by Ofgem on 29 March 2005 as part of the second stage of its consultation on network code arrangements.

⁴ The only changes to the 29 March 2005 draft UNC being the removal of square brackets surrounding references to prospective Gas Transporter Licence Conditions.

material issues are identified in the future, or industry participants disagree with our assessment of the points they have raised through the consultation process, the UNC modification process provides a route for these issues to be addressed.

Finally, Ofgem have requested that we report on the status of both Transco's and Users' development and implementation of the IT systems required to support share sale, including a description of the progress of end-to-end system testing.

The current position with respect to the changes to UK-Link and some of its supporting systems that are required to facilitate a multi-transporter environment is as follows. Changes supporting multiple transporters have been successfully implemented to Conquest, the Internet Access to Data service, M-number database and the related Information reporting systems. All remaining system changes are proceeding to plan after a relatively minor issue with three of the invoicing file formats. The issue has been discussed with the shipper community, and with their support a pragmatic solution has been agreed which will support the planned schedule for DN sales. xoserve's testing of the remaining changes is in the final stages of completion. xoserve, on behalf of Transco, is continuing to provide support to shipper system testing activities. From xoserve's discussions with operational contacts within shipper organisations, Transco believes that shippers' systems will be ready to operate in a post-DN-sales environment within the proposed timescales for DN sales.

Overall, I would like to take this opportunity to thank Ofgem and everybody in the industry involved in this project for their massive efforts in what is a major change to the industry, and which will ultimately bring benefits to consumers. A huge amount of work has been undertaken to allow the sales to proceed and ensure a smooth transition to the new industry structure with minimal disruption. However, we understand and appreciate that the reality and perception of significant change brings with it uncertainty. Whilst I believe that the arrangements we are putting in place are robust and transition will be seamless, I am sure that any unforeseen issues that may arise can be dealt with quickly and effectively.

If you wish to discuss any of the issues raised in this letter, the associated appendices or the attachments, please do not hesitate to contact me.

Yours sincerely

by e-mail

Chris Train

APPENDIX 1

Report on the current status with respect to the conditions precedent to Ofgem's consent to Network Sales as set out in the Direction published on 31 January 2005⁵

The conditions precedent to the Authority's consent to Network Sales are set out below, together with our view, in bold text, of the current status with respect to satisfying these conditions:

Conditions precedent

The consent of the Authority set out in the Direction published on 31 January 2005 is in all respects conditional upon and shall not in any way become effective unless and until:

- (a) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the proposed modifications to each of the Transco Licences as largely set out in the Initial S23 Modifications notice relating to the separation of the price controls and such licence modifications having become effective;

Transco provided written consent to the modifications to each of the six Transco Licences as largely set out set out in the Initial S23 Modification notice relating to the separation of price controls on 31 January 2005, with the Authority (not having received a direction from the Secretary of State not to make any modification) directing the modifications on 1 February 2005, to come into effect on that date.

- (b) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the S8AA Modifications to each of the four relevant Additional Transco Licences (which Transco envisages will at the relevant time relate to each of the four IDNs respectively only) and the Second S23 Modifications to the Original Transco Licence (which Transco envisages will at the relevant time relate to the NTS only) and the one relevant Additional Transco Licence (which Transco envisages will at the relevant time relate to the four RDNs only) and in each case such licence modifications having become effective;

Given our current understanding of the proposed S8AA and S23 Modifications, Transco expects to be able to consent in writing to the proposed S8AA Modifications to each of the four Relevant Transco Licences (in respect of the four IDNs) and the Second S23 Modifications to the Original Transco Licence (in respect of the NTS) and the Additional Transco Licence (in respect of the RDNs), to become effective on a date specified by the Authority (hereinafter "the appointed day"), envisaged to be 1 May 2005.

- (c) The Authority having consented (pursuant to Section 8AA of the Act) in writing to the transfer of the each of four Additional Transco Licences each of which Transco envisages will at the relevant time relate to one of the four IDNs respectively only

⁵ NGT – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks, Decision document Ofgem, February 2005 21/05, Appendix 2

and Transco having actually transferred one of those licences to each of Transco's four relevant wholly owned subsidiaries (one of which is the Company) respectively in accordance with the Authority's consent;

We expect to transfer the Additional Transco Licences (in respect of the four IDNs) to the relevant hive-down Companies to take effect on the appointed day if the Authority consents to such transfer at the Authority meeting on 25 April 2005.

- (d) The Authority being satisfied as to the proposed arrangements as part of the Proposed Transaction for industry codes, including without limitation the UNC and various network codes and (again without limitation) the Authority having directed the Transco Network Code Modification Proposal to be implemented as it better facilitates the relevant code objectives (as defined in the Original Transco Licence) and consequently the modifications to the Transco Network Code having become effective;

In our opinion, the Uniform Network Code (UNC) the Agency Services Agreement (ASA) and the Joint Governance Arrangements Agreement (JGAA) are now sufficiently robust to support a divested industry framework post-hive-down. We consider that the UNC will enable all relevant GT licensees (Transco NTS, Transco RDN, and each prospective IDN) to have in place transportation arrangements via their individual Short-Form Network Codes with effect from the appointed day that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their respective GT licences. Our opinion in this respect is detailed in Appendix 2 to this letter, entitled "Report on the Uniform Network Code (UNC), the Agency Services Agreement (ASA) and the Joint Governance Arrangements Agreement (JGAA) taking account of Stage 2 responses to Ofgem's UNC Consultation on Network Code Arrangements".

In our opinion, the proposed Modification to the Transco Network Code (0745) necessary to modify Transco's Network Code into an individual Short Form Network Code to incorporate, by reference, the provisions of the UNC, better facilitates the relevant objectives as set out in the Original Transco Licence. In particular, we believe that the benefits from comparative competition resulting from the sales as enabled by this modification proposal will deliver the efficiency savings detailed in Ofgem's Final Impact Assessment⁶ on network sales, thus better facilitating the relevant objective under Amended Standard Condition 9(1) of the Original Transco Licence with regard to "the efficient and economic operation by the licensee of its pipeline system". Our opinion in this respect is detailed in the associated Final Modification Report issued to the Authority on 18 April 2005.

Transco will provide the Authority with the format of the proposed individual Short Form Network Codes of the four IDNs (incorporating by reference the UNC) which will, when executed be expressed to take effect from the appointed day, and which shall be identical in all but name to the Transco

⁶ National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004.

Short Form Network Code. These will accompany the Final Modification Report in respect of the Transco Network Code issued to the Authority on 18 April 2005.

Subject to the approval of Network Code Modification Proposal 0745, and approval of the various licence modifications, shippers have been invited to sign four new framework agreements with the four new IDNs during the week beginning 25 April 2005, to become effective on the appointed day. These will provide a contractual relationship between shippers and the new transporters via their individual Short-Form Network Codes (incorporating by reference the provisions of the UNC) for the provision of transportation arrangements on these networks. Transco's current framework agreement will remain in force, effectively ensuring continuity in transportation arrangements to shippers on the NTS and the RDNs.

- (e) The Health and Safety Executive having received safety cases in respect of each of Transco's four relevant wholly owned subsidiary companies (one of which is the Company) (for each of the four IDNs proposed to be hived-down to each one respectively (one of which is the Distribution Network Business)) and in respect of Transco (for the NTS and the RDNs) and each of those safety cases having been accepted by the Health and Safety Executive pursuant to the Gas Safety (Management) Regulations 1996;

The Safety Cases version 4.1, which facilitate hive-down, and which comprise the Transco Safety Case (Transco NTS and Transco RDNs) along with the four IDN Safety Cases, were accepted by the Health and Safety Executive (HSE) on 15 April 2005.

The HSE have completed their assessment of the Scottish Independent Undertakings (SIU) Safety Case version 4.1 and Transco has responded to a small number of clarifications that were sought. Acceptance of the SIU Safety Case version 4.1 is expected prior to 1 May 2005.

- (f) The Secretary of State having granted her consent to the proposed hive-down of each of the four IDNs (one of which is the Distribution Network Business) pursuant to Amended Standard Condition 29 of the Original Transco Licence to each of the four relevant Transco wholly owned subsidiary companies (one of which is the Company) and such consents having unconditionally come into full effect;

The Secretary of State granted her consent to the proposed disposals on 27 January 2005, and published a written ministerial statement⁷ to this effect on 2 February 2005.

- (g) The Secretary of State in exercise of the powers conferred upon her by Section 6A of the Act having, in connection with the Proposed Transaction, made an Order

⁷ Written statement, Department of Trade and Industry, Sale of four National Grid Transco's Gas Distribution Networks - Regulatory Consents granted by the Secretary of State, 2 February 2005

granting an exemption to certain gas transporters in respect of certain gas shipping arrangements as described in the consultation document issued by the Department of Trade and Industry on 19 November 2004 and such Order coming into full force and effect;

The Gas Act 1986 (Exemption) (No. 2) Order 2005 granting an exemption to certain gas transporters in respect of certain gas shipping arrangements was made on 5 February 2005 and laid before Parliament on 11 February 2005. It comes into full force and effect on 1 May 2005.

- (h) Within seven days from the date of this Direction, Transco having procured from NGT an undertaking addressed to the Authority in the form specified by the Authority that NGT will:
- i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of NGT (including for the avoidance of doubt, Transco and its subsidiaries) will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
 - ii. from the date of such undertaking until the date on which the S8AA Modifications and the Second S23 Modifications become effective use its best endeavours to ensure that Transco and, during the period that Transco is the legal or beneficial owner of share capital of the four relevant wholly owned Transco subsidiary companies (one of which is the Company), each such subsidiary company (including the Company) takes steps to implement by 1 September 2005 the enduring offtake arrangements as described in the Authority's Final Impact Assessment in relation to the Proposed Transaction in November 2004⁸ (the "Enduring Offtake Arrangements") in a format approved by the Authority;

The required undertaking was provided by NGT to the Authority on 2 February 2005.

- (i) Within twenty eight days from the date of this Direction, Transco having procured from each of the Purchasers an undertaking addressed to the Authority in the form specified by the Authority that the Purchaser will:
- i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of the Purchaser will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
 - ii. from the date of such undertaking until the date on which the relevant Purchaser becomes (directly or indirectly) the legal or beneficial owner of the share capital of a

⁸ National Grid Transco – Potential sale of gas distribution network businesses. Final Impact Assessment. November 2004

relevant Transco subsidiary company (one of which is the Company), use its best endeavours to ensure that such company takes steps to implement by 1 September 2005 the Enduring Offtake Arrangements in a format approved by the Authority;

The required undertakings were requested by NGT from the Purchasers following the Authority decision, which we understand were subsequently provided to the Authority within 28 days from the date of the Direction.

- (j) The proposed hive-down of the IDNs (one of which is the Distribution Network Business) from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) being consistent with all applicable conditions contained in the Original Transco Licence; and

Transco believes that the proposed hive-down of the IDNs is consistent with all applicable conditions contained in the Original Transco Licence.

- (k) Any other consent; clearance, permission, authorisation or approval required under statute, the Original Transco Licence or otherwise in respect of the proposed hive-down of the IDNs from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) having been unconditionally obtained.

Transco is currently in the process of requesting all the relevant consents identified as being necessary in respect of the Transco NTS licence, the Transco RDN licence, and the four IDN licences, such that they become effective from the appointed day. The majority of such consents have already been requested, and Transco expects to submit any outstanding requests imminently.

Other than the approval of the SIU Safety Case by the HSE, Transco believes that no other such consent, clearance, permission, authorisation or approvals are required in respect of the proposed hive-down of the IDNs under statute or in respect of the Original Transco Licence.

APPENDIX 2

Report on the Uniform Network Code (UNC), the Agency Services Agreement (ASA) and the Joint Governance Arrangements Agreement (JGAA) taking account of Stage 2 Responses to Ofgem's UNC Consultation on Network Code Arrangements

Summary

Taking into account comments received following the closure of Ofgem's consultation on network code arrangements⁹, we now consider the UNC, ASA and JGAA to be sufficiently robust and fit-for-purpose to support a divested industry structure from 1 May 2005. We consider that the UNC will enable all relevant GT licensees (Transco NTS, Transco RDN, and each prospective IDN) to have in place transportation arrangements via their individual Short-Form Network Codes from the Appointed Day (1 May 2005) that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11 (1) of their prospective GT licences.

In terms of the UNC, having carefully considered respondents' views in response to the second stage of Ofgem's consultation and our own assessment of the document, we have not identified a requirement for any material changes to the document at this stage. Clearly, if any material issues are identified in the future, or industry participants disagree with our assessment of the points they have raised through the consultation, the modification process provides a route for these issues to be addressed. We have however identified 23 minor typographical/cross referencing errors in the UNC that will be corrected, together with one deletion of redundant text erroneously included in the Stage 2 document. We propose to address these by seeking Ofgem's consent to modify the UNC under Standard Special Licence Condition A11(13) immediately after hivedown.

We therefore believe that the UNC considered as part of Stage 2 of Ofgem's consultation on network code arrangements is in a form which is sufficiently robust to allow hive down, and therefore have therefore provided this version to Ofgem as the day 1 UNC as being appropriate to support the divested industry structure from the Appointed Day (1 May 2005).

In respect of the ASA, we have identified one minor change. In respect of the JGAA, we have identified four minor changes. We will amend these documents accordingly prior to hive-down.

Introduction

Ofgem's 5-week consultation on Network Code Arrangements invited responses on the UNC, ASA, JGAA and the IExCR Statement as part of a two-stage consultation process. The consultation was launched on 4 March 2005, with Stage 1 responses due by 18 March 2005. This afforded Transco the opportunity to refine the documents in response to comments received, and provide these updated documents to Ofgem for Stage 2 of their consultation. Stage 2 was subsequently launched on 29 March 2005 with responses due by 12 April 2005.

⁹ Ofgem Open Letter Gas Distribution Network Sales – Consultation on Network Code Arrangements – March 2005

We welcome the level of detail in the responses provided by respondents as part of Stage 1 of the consultation. We carefully considered each comment raised, and responded to each individual point within the matrices issued with the Stage 2 documents, highlighting the changes we made to the documents in response to these comments.

Stage 2 responses have now been submitted to Ofgem. The purpose of this report is to summarise and provide our response to the comments received in respect of these documents, and propose a way forward in dealing with any issues arising as a result of the consultation.

Summary of Responses

Ofgem received a total of thirteen responses as part of the second phase of its consultation on Network Code arrangements, which closed on 12 April 2005. Responses were received from:

BP	npower
Centrica Energy	Scottish and Southern Energy
CKI/UU Consortium	Scottish Power
E.ON UK	Shell Gas Direct Ltd
Gemserv	Statoil
MGN Gas Networks	Total Gas and Power
NGT	

Aside from the specific issues raised in respect of the documents themselves, which are addressed in the following section, the general issues raised in respect of the UNC as part of these responses, together with our views on these issues, can be summarised as follows:

Process & Timetable

Respondent views on process were mixed, with buyers commending the rigorous nature of the development process we have undertaken, affording all stakeholders the opportunity to participate in the development of the UNC, with the opportunity to comment and contribute at all stages of the process. There was appreciation of the considerable effort invested in the development of the documents, and that the five-week Ofgem consultation, split into two stages, has enabled the development of a robust UNC suitable to support a multi-GT environment. One respondent noted that they were comfortable that minor drafting changes that are identified can be dealt with after hive down.

Buyers and some shippers were appreciative of the fact that Transco had considered and addressed many of the points raised as part of Stage 1 of the consultation, and that many of their comments had been taken on board. Some shippers expressed some disappointment that we did not take on board all of their suggested changes, and that they still considered these points to be relevant. Where such points have been raised again as part of Stage 2, we have considered them further in the UNC Stage 2 Response Matrix accompanying this report.

One shipper raised concerns about the process for establishing the legal text, suggesting that development of the business rules and legal text should have been undertaken sequentially. In response, the business rules were developed with the industry over a period of several months prior to being consulted upon as part of Transco's "Towards a

new Industry Framework” consultation in December 2004. The legal text was subsequently developed from these business rules. However, the business rules were a ‘means-to-an-ends’ in developing the initial legal text, after which the focus was on developing the final legal text for the UNC itself, with refinements to this text discussed through the numerous legal drafting sessions held throughout January and February 2005. This approach is also consistent with the way in which other major revisions to the Network Code have been managed e.g. RGTA. These sessions dealt with a whole range of policy and legal drafting issues, which were captured in an action log and dealt with as they arose. Back-engineered business rules reflecting the final legal text would therefore have little value.

Two shippers expressed their concern over the timetable, considering it to be overly ambitious, therefore not providing sufficient opportunity to fully participate in the development of the new arrangements, or to fully review the large volume of documentation produced. In contrast, one shipper acknowledged that despite shipper reservations about timescales, the detail in the UNC document had been consulted upon, and that shippers had the opportunity to discuss changes to the Network Code on a section by section basis. In response to the concerns raised in respect of the timetable, whilst we understand the resource constraints, particularly on the smaller shippers, we believe that considerable participation and input from representatives across the industry has occurred, and that this has been critical to the development of a robust contractual framework to support network sales. As noted by several respondents, the governance of the contract will enable any issues that arise after hive-down to be quickly remedied.

In developing the UNC, one shipper suggested that meetings were not minuted, and actions not followed up. In response, we consider that all but two UNC Development Forum meetings were minuted (and that those that were not minuted occurred early in the programme), and issues raised in all UNCDF, ERF meetings and UNC legal drafting sessions were recorded in action logs and dealt with. These action logs were shared with the industry on an ongoing basis and ultimately closed down when all the issues raised had been addressed.

One shipper raised concerns over the late publication of documents to be discussed at meetings, premature publication of documents, late changes to meeting schedules, and changes to the programme at short notice. In response, we have always sought to deliver documents as early as possible, provide agendas in advance and publish documents, often as drafts for discussion, to aid transparency. Any changes to the programme have either been driven by unexpected issues that have surfaced, or to further enhance the process – for example, the two-stage five-week consultation has enabled Transco to refine the UNC during the process in response to industry comments, which we believe has resulted in a much more robust set of documents than would otherwise been possible.

One shipper noted that the UNC should have been developed under the governance of the Network Code Modification Panel. However, as we have previously stated, transportation arrangements in respect of the IDNs could not be established by a formal modification to the Transco Network Code – and therefore could not sit under the governance of the Network Code Modification Panel. We have therefore sought to emulate a formal process as far as possible in developing the UNC, with development of business rules through policy discussions at DISG and development workgroups, followed by consultation on those rules. Drafting sessions were also held for development of the associated legal text, ultimately leading to Ofgem’s five-week consultation on the draft

UNC. One respondent argued that the development process had been more rigorous, transparent and engaging than the accepted process for change enjoyed through the formal Network Code modification route.

General Comments on the UNC

One respondent noted that there were significant issues as yet unresolved in terms of Sections B & J on Capacity and Exit Requirements, on the Modification Rules and on the Transition Document. However, in response, we believe that we have addressed all the specific points raised in respect of these sections of the UNC where we consider these to be valid, and consider these sections to be robust.

Another respondent (npower) noted that Transco had used the time during the two-stage, five-week consultation process to make further refinements to the documents, and while corrections to cross references and typographical errors were welcomed, concerns were expressed over new clauses that had been inserted and old clauses deleted without discussion with the rest of the industry. We recognise the concern, but in general all such changes were non-material drafting clarifications and technical drafting improvements, and identified as such in the published Drafting Changes Guides. npower identified a number of changes which they consider to have been inadequately explained in either the matrices or the Drafting Changes Guides published after stage 1. We are therefore providing with this letter a further document, entitled “npower Matrix”, which sets out the background and rationale to the changes identified by npower. We hope that this will aid transparency and allay concerns in this area. However, we would be happy to discuss any residual concerns participants might have in respect of these changes, and if participants consider any of these changes to be inappropriate, we would be happy to consider revisions to the text via a modification proposal post hive-down.

Another shipper commented that they have no further comments to make on the UNC drafting itself and consider that the majority of that document provides a satisfactory contractual framework for the industry in the post-DN sales environment.

Governance

Of the thirteen responses, four shippers and a non-Code party expressed their continued concerns over the proposed changes to the governance arrangements, particularly with regard to changes to the Modification Rules and Modification Panel composition, considering these to be over and above those necessary for network sales. In contrast, one shipper expressed support for the proposals, but suggested that the shipper quota might be split to allow for greater participation of a diverse range of shipper views.

The key concerns expressed were in relation to the proposed 5:5 split between GT and shipper voting and representation on the Modification Panel, the need for a Panel Recommendation in preference to a transporter recommendation, and the inefficiencies resulting from introducing the need for a Panel Recommendation into the modification process. Concern has been expressed in particular over the introduction of a Panel Recommendation before there is a clear understanding of how the DTi Appeals process might operate.

Concerns were also expressed over the process adopted in taking forward these proposals; that they had not been the subject of any of Ofgem’s prior consultations or Authority decisions, and also that proposals discussed through DISG had been in the

context of the prospective DTI Appeals process. It was suggested that NGT has adopted Ofgem's suggestions as a requirement, to avoid the need for consultation.

In response, we consider that governance arrangements reflecting a multi-transporter environment have been under extensive discussion with the industry for some time through DISG, UNCDF and the UNC legal drafting sessions, culminating in the proposals we have put forward within the UNC as part of Ofgem's consultation. We are firmly of the view that the current arrangements need to be reformed to support a divested industry structure, allowing the new transporters a say in the governance of the contract, and enabling each to comply with licence requirements in respect of the provision of transportation arrangements that satisfy their relevant objectives. It would be inappropriate for Transco to continue to undertake all of the roles which it presently fulfils – for example, it would be inappropriate for the so-called Transco veto to be retained.

The proposals we have put forward do not and are not intended to pre-judge the DTI Appeals process and are not dependent upon that process; we consider the proposals necessary and appropriate to support a multi-transporter environment, allowing for equitable representation of Users and Transporters in the governance of the contract following network sales. The aim is to produce a balanced Panel, capable of representing the parties on either side of the contract.

Furthermore, in addition to ensuring that any recommendation to modify the contract captures the views of parties on both sides of the contract, the introduction of a Panel Recommendation is consistent with views put forward by Shippers during debates on governance issues that the role of Users should be increased. Accordingly, we believe that a Panel Recommendation, derived from Voting Members of the Panel, provides an efficient means of deriving a recommendation on whether a particular proposal should be implemented. We acknowledge that introduction of additional steps into the governance process could be regarded as inefficient at that point in the overall process relative to the current arrangements. However, we consider that the enhanced inclusivity of the process, capturing the views both of Transporters and Users in making a recommendation to the Authority, provides additional information which would be expected to promote greater efficiency in terms of seeking a decision from the Authority on whether or not a proposal should be implemented.

Having considered views expressed through Ofgem's consultation, we do not consider that retaining the current arrangements would be appropriate in a multi-transporter environment. We consider that a balanced 5:5 panel structure with equal transporter and shipper representation to be both appropriate and efficient in governing the UNC in a multi-transporter environment. Furthermore, we consider that a Panel Recommendation is the most democratic, efficient, inclusive and transparent means of providing a recommendation to the Authority on whether a particular proposal should be implemented or not. However, we are committed to reviewing these arrangements when there is clarity on how the DTI Appeals process will operate.

Exit Reform

Two respondents reiterated their concerns over exit reforms, the linkage with the sales process and the pace at which it is being introduced, allowing little time for proper consultation or to effect successful implementation. However, in response, the Authority concluded as part of its decision in January to consent to network sales that Exit Reform was necessary to protect the interests of consumers under a divested industry structure,

and that these arrangements should be brought forward by September 2005. Accordingly, we are seeking to take forward these reforms and involve the industry in their development – hence the industry meetings and consultations we are currently undertaking on these proposals.

Metering

One respondent expressed their concerns over the lack of time for the commercial negotiation of the revised metering contracts and the number of new agreements required to be in place before hive-down. In response, Transco's metering business is actively engaged with Suppliers in respect of the contracts they will be required to sign. We recognise that there are a number of contracts for each supplier to sign, but these represent minimal change from the existing suite of contracts and effectively ensure the continuity of current arrangements. Another respondent noted the considerable progress that has been made in this respect, and that the minimal change approach has led to a considerable reduction of their cost estimates resulting from the sales.

Related UNC Documents

One shipper expressed disappointment over the availability of new and existing ancillary documents. The Network Code ancillary documents are already in existence and available to the industry – although these have now been re-badged to reflect the multi-GT environment and made available on our website (www.transco.co.uk -> Network Sales -> Uniform Network Code -> Related Documents). Many of the new documents that are ancillary to the UNC - for example the SME Code of Conduct, the Offtake Capacity Statements and the IExCR statement – have been available to industry participants for some time, and are now available on the website.

Signing Process

One respondent raised concerns over the signing process for the various agreements to support the sales, and in particular was concerned that the process was not being centrally managed. However, we have published a comprehensive summary of all the various contracts requiring signature and the process for dealing with each, and we hope that this will help aid clarity. Transco has appointed Denton Wilde Sapte (DWS) in this respect and they have written to shippers detailing the precise arrangements for signing up to the new framework agreements, and Transco's contract management team is liaising directly with their operational counterparties in shipper organisations to assist them in this process. Our contract management team is also handling, where required, the novation of NExA and siteworks agreements, and establishing new confidentiality agreements. Transco's credit management team are dealing directly with their shipper counterparties with regard to the necessary security cover required in respect of the new IDNs. Business separation obligations mean that dealings with suppliers on metering contracts needs to be handled separately, and Transco's metering business is actively engaged with suppliers in respect of these contracts.

Specific Comments on the UNC, ASA, JGAA and the IExCR Statement

In response to specific comments on these documents, we have prepared a response matrix to accompany this report – “UNC Stage 2 Response Matrix” - identifying the particular points raised in respect of each document. We have carefully considered each

of the points raised, providing a response to each, and where we have considered these points merit a change to the documents, we have provided our suggested way forward. Transco's response to each comment were assessed against five categories, as follows:

Category 0: No change to document - Transco does not consider that any change is needed to the document.

Category 1: In respect of the UNC, Transco accepts that the typographical or cross-referencing error identified needs to be corrected. In respect of the UNC, Transco proposes to seek Ofgem's consent, immediately after hive-down, to modify the UNC under Standard Special Condition A11(13) of its Licences in order to correct these errors as soon as possible. In respect of the ASA and JGAA, Transco proposes to make any required modifications such that they will be effective from hive-down.

Category 2: Transco does not believe that the point raised requires a change to the UNC. However, if respondents disagree with Transco's view, they are free to raise a Modification to the UNC after hive-down to address their concern.

Category 3: Transco accepts the point raised in respect of the UNC but believe that further consultation would be necessary in order for this to be incorporated in the UNC. However Transco considers that this point is not sufficiently material to justify the delay to hive-down (and consequential delay to the timetable for the transaction and delivery of consumer benefits identified in Ofgem's Final Impact Assessment) that consultation prior to hive-down would cause. Instead Transco proposes to work with the community to raise an appropriate Modification shortly after hive-down.

Category 4: Transco accepts the point raised and considers that this is sufficiently material to delay hive-down to allow further consultation on the UNC to accommodate the issue raised.

As the analysis in the UNC Stage 2 Response Matrix shows, in our opinion non of the points raised fall into Categories 3 and 4. In our opinion, all our responses to the points raised fall into Categories 0, 1, or 2.

The changes identified as a result of this analysis (i.e. Category 1 issues) are detailed in Appendix 3. All relate to the JGAA and ASA; none relates to the UNC.

In parallel with Stage 2 of the consultation, Transco reviewed the documents to identify any non-material changes required as a result of typographical, layout, or referencing errors. 24 such non-material changes were found; they are set out in detail in Appendix 4. All 24 relate to the UNC.

Below we summarise, by document, the changes we propose to make.

UNC General Terms – Whilst a number of points (7) were raised in respect of this section of the UNC, no further amendments have been identified as being necessary, other than the correction of six minor errors identified by Transco in the table in Appendix 4. We propose to seek Ofgem's consent to modify the document in respect of these corrections immediately following hive-down.

UNC Transportation Principal Document – A number of points (15) were raised in respect of this section of the UNC. Having carefully considered each point raised, no further amendments have been identified as being necessary as a result. However, Transco has identified 15 minor errors (listed in the table in Appendix 4) that require correction. We propose to seek Ofgem’s consent to modify the document accordingly immediately following hive-down.

UNC Offtake Arrangements Document – Only one comment was received in respect of this document, but we do not consider that any further any modification is required at this stage in respect of it. Transco has identified one typographical error, identified in the table in Appendix 4. We propose to seek Ofgem’s consent to modify the document in respect of this correction following hive-down.

UNC Modification Rules – A number of specific comments (33) were received on this section, some of which relate to the 5:5 panel constitution and the concept of a Panel Recommendation on whether modification proposals should be implemented. Having carefully considered each of the specific points raised, we do not propose any changes to this document.

UNC Transition Document – No specific comments were received in respect of this document. Transco identified two typographical errors (identified in Appendix 4) and we propose to seek Ofgem’s consent to modify the document to correct these errors immediately following hive-down. We do not consider that any other modifications are required at this stage.

Agency Services Agreement - Comments were received expressing concern that this was not fully compatible with the business model of one of the buyers. We therefore propose to amend the document before hive-down by making one minor amendment with respect to the appointment of agents by a network operator.

Joint Governance Arrangements Agreement – Comments were received in respect of this Agreement not being fully compatible with the business model of one of the buyers. We propose to amend the document to accommodate this business model. A small number of additional comments were made, only two of which – a typographical error and a technical amendment – require a change. We propose to make these amendments before hive-down.

IExCR Statement - No comments were received in respect of this document. We do not consider that any further any modification to this document is required at this stage.

Assessment of the UNC against the relevant objectives

We consider that the UNC in its current form will enable all relevant GT licensees (Transco NTS, Transco RDN, and each prospective IDN) to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their prospective GT licences as follows:

- **SSC A11 1 (a)**, *‘the efficient and economic operation of the pipe-line system to which this licence relates’*

- By allowing costs of operation and performance to be judged in a environment of comparative competition by introducing of new distribution network operators as cost and performance comparators in setting future price controls. This will create stronger incentives to reduce costs and improve performance, thus promoting the efficient and economic operation of the pipe-line system.
- By ensuring that each transporter is responsible and fully accountable for the safe, efficient and economic of its own network, consistent with the conclusions of Ofgem's Roles and Responsibilities RIA¹⁰.
- **SSC A11 1 (b)**, *"... the co-ordinated, efficient and economical operation of (i) the combined pipeline and/or (ii) the pipeline systems of other relevant transporters"*
 - By the introduction comparative competition in setting future price controls and performance targets, thus allowing the consumer benefits identified in Ofgem's Final IA to be realised.
 - By the introduction of a common contractual framework for the provision of transportation services.
 - By allowing Transco NTS to retain the residual gas balancing the role and the obligations associated with energy settlement for the Total System consistent with the conclusions of Ofgem's Roles and Responsibilities RIA.
 - By a single service provider (the transporter Agency) undertaking many of the system and data related services currently carried out solely by Transco on behalf of shippers and suppliers consistent with the conclusions of Ofgem's Agency RIA¹¹, thus promoting the efficient and economic provision of commercial transportation services to shippers and suppliers.
- **SSC A11 1 (d)** *'... the securing of effective competition*
 - (i) *between relevant shippers and (ii) relevant suppliers – again* by the introduction of a common contractual framework for the provision of transportation services to shippers and by a single service provider (the transporter Agency) undertaking many of the system and data related services currently carried out solely by Transco on behalf of shippers and suppliers consistent with the conclusions of Ofgem's Agency RIA. *and/or*
 - (iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers'* – by the introduction of an environment of comparative competition in terms of cost and performance, and by the provision of a common set of transparent commercial offtake arrangements in respect of the NTS/DN interface under the UNC Offtake Arrangements Document (OAD) within the UNC.

¹⁰ Ofgem 119/04: "National Grid Transco – Potential sale of gas distribution network businesses: Allocation of roles and responsibilities between transmission and distribution networks: Decision document", May 2004.

¹¹ Ofgem 120/04: "National Grid Transco – Potential sale of gas network distribution businesses: Agency and governance arrangements: Decision document", May 2004.

Taken together, Transco considers that the adoption of a common contractual framework that provides for obligations to be discharged centrally by common service providers, and the prospect of customer benefits through comparative regulation, would serve to facilitate the achievement of each of the relevant objectives set out above.

Transco also consider that the proposed modification rules associated with the UNC, administered by the Joint Office, would better facilitate the relevant objective 1 (f) under the proposed SSLC A11 for each relevant transporter – “...the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code”. We believe that the proposed governance arrangements contained within the UNC would provide efficiency in the governance of the UNC by ensuring the balanced representation and full participation of transporters and shippers in making recommendations to the Authority on modifications to the UNC.

Overall Assessment

Taking account of responses to the second stage of the consultation, and our own assessment, we have not identified any issues sufficiently material to warrant changing the UNC¹² prior to hive-down. Furthermore, other than to review the modification rules when there is clarity on how the DTi Appeal process will operate, we have not identified any material issues at this stage which might in Transco’s opinion merit consideration in the future. However, this does not fetter the ability of any interested parties to utilise the UNC Modification Procedures following hive-down to address any residual concerns they may have, or to put forward modification proposals if they disagree with our assessment.

Following this analysis, we now consider the UNC, ASA and JGA to be sufficiently robust and fit-for-purpose to support a divested industry structure from 1 May 2005. The amendments to the documents in response to comments raised following Stage 1 of the consultation proved extremely useful in refining these documents such that they can be considered as such.

We have however identified 23 minor typographical/cross referencing errors in the UNC that will need to be corrected, together with one deletion of redundant text erroneously included in the Stage 2 document. These minor errors do not, in our view, prejudice the suitability of the UNC for operation in a post sales environment, nor are they material. We propose to address these by seeking Ofgem’s consent to modify the UNC under Standard Special Licence Condition A11(13) immediately after hive-down.

In respect of the ASA, we have identified one minor change. In respect of the JGAA, we have identified four minor changes. We propose to amend these documents accordingly prior to hive-down.

We therefore believe that the UNC considered as part of Stage 2 of Ofgem’s consultation on network code arrangements is now in a form which is sufficiently robust to allow hive-down to occur. We consider this version of the UNC to be consistent with all relevant Authority decisions associated with network sales. We also consider that the UNC in this form will enable all relevant GT licensees (Transco NTS, Transco RDN, and each

¹² References to the UNC, JGAA and ASA relate to the draft versions published by Ofgem on 29 March 2005 as part of the second stage of its consultation on network code arrangements.

prospective IDN) to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their respective GT licences.

We have therefore provided the UNC considered as part of Stage 2 of the consultation to Ofgem as the day 1 UNC¹³ as being appropriate to support the divested industry structure from the Appointed Day (1 May 2005).

¹³ The only changes to the 29 March 2005 draft UNC being the removal of square brackets surrounding references to prospective Gas Transporter Licence Conditions.

APPENDIX 3: **Changes identified by participants in Phase 2 of UNC consultation**

Changes to be made to the UNC as soon as possible after hive-down

None.

Changes to be made to the Agency Services Agreement and the Joint Governance Arrangements Agreement before signing

Document	Section	Change	Type of change	Plan for resolution
ASA	Part 8	Clarify that a network operator may appointment an agent for various activities covered by the ASA.	Minor amendment	Drafting will be updated prior to signing of agreement
JGAA	11.2.1	Amend definition of "Affiliate" to align with TPD and OAD, thus allowing disclosure to a 10% shareholder.	Minor amendment	Drafting will be updated prior to signing of agreement
JGAA	19.3	Clarify that nothing in the JGAA prevents a transporter from appointing an agent (cf. TPD V6.5.7).	Minor amendment	Drafting will be updated prior to signing of agreement
JGAA	Schedule 2, paragraph 1	Replace "expression" with "expressions".	Typographical	Drafting will be updated prior to signing of agreement
JGAA	Schedule 2, paragraph 1	Replace "Any capitalised terms used, but not defined, in this Accession Agreement shall have the meaning given to it in the Uniform Network Code" with "Any capitalised terms used in this Accession Agreement, but not defined in this Accession Agreement or the JGAA, shall have the meanings given to them in the Uniform Network Code".	Technical amendment	Drafting will be updated prior to signing of agreement

APPENDIX 4: Changes identified by Transco

Changes to be made to the UNC as soon as possible after hive-down

Document	Section		Change	Type of change	Plan for resolution
General Terms	A	2.2.8	In first line, replace "2.2.6(a)" with "2.2.7"	Typographical	Seek consent to modify
General Terms	A	2.2.8(b)(i)	Replace "2.2.6(b)(i)(ii)" with "2.2.6(b)(ii)"	Typographical	Seek consent to modify
General Terms	A	2.2.8(b)(ii)	Replace "2.2.6(b)(i)(i)" with "2.2.6(b)(i)"	Typographical	Seek consent to modify
General Terms	A	2.2.8(b)(iii)	Replace "2.2.6(b)(i)(i)" with "2.2.6(b)(ii)"	Typographical	Seek consent to modify
General Terms	B	2.4.1	Delete "(d)"; adjust indentation so as to apply the text formerly within (d) to all of (a), (b) and (c); delete ";" at end of (c).	Typographical	Seek consent to modify
General Terms	C	3.3.1(c)(i)	Replace "an" with "a".	Typographical	Seek consent to modify
TPD	B	1.7.10	Replace "Standard Special Condition A26(4)" with "Standard Condition 7(5)"	Correction of reference	Seek consent to modify
TPD	B	4.6.9(b)	Replace "(ci)" with "(c)".	Typographical	Seek consent to modify
TPD	B	4.6.9(b)	Replace "(f)" with "(d)".	Typographical	Seek consent to modify
TPD	B	6.1.2	Replace "1.13" with "1.12".	Typographical	Seek consent to modify
TPD	D	1.4.1(g)	Replace "Operational Guidelines" with "statement prepared by Transco NTS pursuant to Special Condition C5(5) of Transco NTS's Transporter's Licence".	Correction of reference	Seek consent to modify
TPD	D	2.1.1	Replace "Standard Special Condition A16" with "Standard Special Condition A11(22A and 22B), inserted by Special Condition C6".	Correction of reference	Seek consent to modify
TPD	F	6.5	Before (a), insert "The "Adjustment Reconciliation Neutrality Amount" for a relevant month (month 'm') is:"	Typographical (text missing in current Transco Network Code)	Seek consent to modify
TPD	J	3.4.6	Replace "or (i)" with "or (ii)".	Typographical	Seek consent to modify
TPD	J	3.11.1	Replace "3.10" with "3.11".	Typographical	Seek consent to modify
TPD	J	3.11.7	Replace "Transco" with "the Transporter".	Typographical	Seek consent to modify
TPD	R	1.11	Delete " other than a DNO User in its capacity as an LDZ Shrinkage Provider".	Consistency with Section N	Seek consent to modify
TPD	V	5.5.3(g)	Replace "Standard Condition 7" with "Standard Special Condition A31".	Corrects reference	Seek consent to modify
TPD	V	7.1.1(b)	Replace "ransporter" with "Transporter"	Typographical	Seek consent to modify
TPD	V	9.4	Insert "Uniform" before "Network Code Operations Reporting Manual" (5 times)	Typographical	Seek consent to modify
TPD	V	9.4.5	Delete "(d)" since paragraph not used.	Typographical	Seek consent to modify

OAD	L	3.1.1	Replace "the payee shall prepare and send to the payee" with "the payee shall prepare and send to the payor".	Typographical	Seek consent to modify
Transition Doc	IIA	2.1	Replace "UNC Modification Date" with "UNC Implementation Date"	Typographical	Seek consent to modify
Transition Doc	IIC	1.4.1(d)	Replace "TPD R4.6.3" with "TPD R4.4.3".	Typographical	Seek consent to modify

Changes to be made to the Agency Services Agreement and the Joint Governance Arrangements Agreement before signing

None.