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Dear Sonia

**National Grid Transco – Potential Sale of Gas Distribution Network Businesses
Formal Consultation under Section 23 and Section 8AA of the Gas Act 1986.**

Thank you for the invitation to comment on the above formal consultations.

We very much welcome the inclusive approach Ofgem has adopted to the development of the licences that will apply to Transco and the future independently owned gas distribution networks (IDNs). In particular, we acknowledge the numerous opportunities that Ofgem has provided over recent months to comment upon the proposed licence drafting and we note that many of our comments in respect of both policy and drafting issues have been reflected in the current proposals.

However, there remain a number of areas where Ofgem's policy decisions do not reflect our views, including:

the metering obligations of last resort; the lack of geographic limitation on the obligation to offer terms for competitive metering and/meter reading services; the onerous obligations in respect of the DN's procurement and use of system management services that (in our view, inappropriately) replicate the NTS requirements; the introduction of new standards of performance on connections for the IDNs; and the reform of DN exit arrangements.

In addition to the above, we are disappointed by Ofgem's recent policy decision to introduce a "best endeavours" obligation in respect of the business separation licence condition. Until very recently, the proposed obligation reflected the "reasonable endeavours" obligation associated with the equivalent electricity distribution licence condition. We therefore see no reason why Ofgem is of the view that the regime should be changed for gas, following the sale of the DNs.

Similarly, we are disappointed that Ofgem has continued to progress the introduction of a new licence obligation in respect of price control review information (Standard Special Condition A40. Price Control Review Information). We recognise that this condition replicates recent proposals for the modification of the electricity distribution licence. However, this condition is not required for the DN sales process and therefore its introduction would, in our view, be more appropriately considered at the time of the next DN price control review.

Our views on each of these issues and the rationale behind them have been provided in previous correspondence and we have not therefore repeated them here. We would however urge Ofgem to consider the possibility of reviewing these policy issues at the earliest opportunity, following completion of the sales process.

Points to be addressed

Notwithstanding the above policy issues, we do believe that there are a number of issues within the proposed licence conditions that are being consulted upon that could be addressed at this stage and that would not, in our view, require further consultation.

Standard Special Conditions D3. Long term development statements

Ofgem is currently consulting on the future scope, form and timing of the long term development statements provided for under these conditions and we shall respond to that accordingly. However, we believe that the wording in paragraph two should revert to the existing wording of Amended Standard Condition 25 so that it reads “Except in so far as the Authority consents to the licensee not doing so, the licensee shall on an annual basis prepare a revision of any statement prepared under paragraph one so as to ensure that, so far as is reasonably practicable, the information in the revised statement is up to date”. We see no reason to change this wording to the proposed “reasonable endeavours” obligation to perpetually update the statement throughout the year. This is not required for DN sales and we believe that it is impractical and potentially extremely costly.

Special Condition D4. Prohibited Procurement Activities

We are unsure whether this condition, as drafted, could prevent the DN from trading capacity and flow flexibility for efficiency purposes (rather than for explicit capacity management purposes). The enduring offtake arrangements business rules would allow the DN to trade capacity in order to manage its capacity holding at the NTS/DN offtake for purposes other than constraint management (for example, for efficiency purposes in line with the proposed enduring incentive arrangements). As currently drafted, we believe this condition could prevent such activity. We understand that Ofgem is aware of this potential issue and will ensure that there is no unintended misalignment between the licence obligations and business rules.

Special Condition D5. Licensee's Procurement and Use of System Management Services

As drafted currently, we understand that this condition applies collectively to the four RDNs. However, we question whether it should apply separately to each of them, consistent with other reporting obligations? If Ofgem agrees, we believe a change of this nature would be possible at this stage since it would be consistent with Ofgem's policy in respect of RDN reporting.

Special Condition D6. Provision of First Call Emergency Response to the NTS Operator

We continue to believe that paragraph 2 is too widely drafted and could require the DN to perform *any* work that the NTS may request it to do, whether or not it is appropriate. We therefore continue to believe that, at the very least, paragraph 2 should be amended so that it reads "...unless reasonably requested and/or authorised to do so by the NTS operator". However, we recognise that it would not be possible to change the drafting at this stage and, therefore, some form of comfort would be welcome that the DN would not be required to do anything that was not reasonable.

Special Condition E2A. Revenue restriction definitions in respect of the Distribution Network

- We believe a definition in respect of "distribution network capacity" is required since it is referred to in Part 2 Paragraph 14(6)(i). Currently the term used is "LDZ capacity" which is a defined term, but this reference in that paragraph has been changed to "distribution network capacity" without a corresponding definition.
- The definition of "curtailment day" has been removed to the NTS definitions, however we believe it is also required for the DN definitions since it is referred to in Special Condition E6 under "Exit Information Reporting".
- The definition of "formula year" states that $t=1$ means the year starting 1 April 2004. For clarity we believe it may be helpful to add the words "except in relation to Special Condition E5 where $t=1$ means year commencing 1 April 2002 at 06:00hrs".

Other minor drafting points

We have identified a couple of drafting points as set out below.

Standard Special Condition A11

Paragraph 1.(b) reference to "economical" should be "economic".

Standard Special Condition A50

Paragraph 8. (iii) second line, after "; and" there should be a paragraph break so that point (iv) starts as a new paragraph.

Finally, as mentioned in our comments on the policy issues above, we do not support Ofgem's policy in respect of a licence obligation to reform the DN exit arrangements by

2006. Nevertheless, in recognition of Ofgem's position we would very much welcome the opportunity to meet with you to discuss Ofgem's expectations of such a reform.

We very much hope that you will find the above comments useful. Please give me a call if you would like to discuss any of the points we have raised.

Yours sincerely

Rob McDonald
Director of Regulation