

Shippers, National Grid Transco and
other interested parties

25 April 2005

Dear Colleague,

Ofgem approves next stage of NGT's sale of four of its gas distribution networks

Following the conditional decision of the Gas and Electricity Markets Authority (the Authority) on gas distribution network (DN) sales in January 2005, the Authority has today met to consider whether Transco plc¹ (Transco) has fulfilled the conditions precedent which were attached to the Authority's consent to hive-down four DNs from Transco to four wholly owned Transco subsidiary companies.²

Having due regard to its principal objective and statutory and other public law duties, and having carefully considered representations and objections received in the various related consultations, the Authority has concluded that the conditions precedent have been sufficiently satisfied to allow hive-down to occur on 1 May 2005. However, before hive-down can complete, the Authority intends to write to Transco requesting its confirmation that the conditions have been fully satisfied.

The purpose of this letter is to set out the reasons for the Authority's decision. To this end, this letter:

1. sets out the background to the conditions to consent;
2. sets out the basis for the Authority decision on conditions precedent;
3. details the conditions to consent that must be satisfied prior to hive-down, the progress made to satisfy each condition precedent and the Authority's views on the extent to which each condition precedent has been satisfied;
4. sets out the overall conclusion of the Authority's views in relation to conditions of consent; and
5. sets out the way forward.

¹ Transco plc is a wholly owned subsidiary of National Grid Transco plc (NGT).

² The conditions precedent are described in Appendix 2 of the Authority's Consent Directions. *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks Authority decision*, 1 February 2005, 21/05. (the "Consent Directions") Appendix 2.

1. Background to the conditions to consent

In May 2003, National Grid Transco plc (NGT) announced that it would consider the sale of one or more of its DNs if such a transaction was to maximise shareholder value. Any such sale would represent a fundamental change to the structure of the gas industry and would require the consent of the Authority under Amended Standard Condition 29 (ASC 29) of Transco's original Gas Transporter (GT) licence as well as consent from the Secretary of State for Trade and Industry. In addition, safety cases under the Gas Safety (Management) Regulations 1996 (GS(M)R) would need to be accepted by the HSE.

Following NGT's announcement, Ofgem undertook a significant programme of work and consultation to investigate the potential costs and benefits that such a transaction could deliver for customers.³ This process has included the establishment of a number of industry workgroups, including the Development and Implementation Steering Group (DISG)⁴, which are (and have been) open to all interested parties to attend. In addition, Ofgem has consulted on a series of Regulatory Impact Assessments (RIAs) which considered key aspects of the regulatory, commercial and operational framework required to protect the interests of customers in the event that the proposed DN sales were to proceed.

The completion of these RIAs and associated conclusions documents culminated in the publication of a Final Impact Assessment (Final IA) in November 2004. As part of this Final IA, Ofgem undertook an examination of the potential costs and benefits associated with the proposed overall industry framework that would protect the interests of customers in a divested industry structure, and derived an estimate of the potential net costs and benefits that could be achieved for customers if the transaction were to occur. Ofgem's base case estimate highlighted that net benefits to customers could potentially be in the order of £225 million, in present value terms, if NGT were to sell four of its DN businesses.⁵

On 11 January 2005, Transco submitted four applications to the Authority under ASC 29 of its original GT licence. The applications requested the Authority's consent to the proposed disposal of four of Transco's eight DNs to four separate wholly-owned subsidiary companies, the shares in which would subsequently be sold to third party purchasers⁶. These applications for consent were considered at a duly convened meeting of the Authority on 20 January 2005. On 11 January 2005, Transco also requested the transfer of the four relevant GT licences to the four wholly owned subsidiaries.

³ A full list of documents published by Ofgem in respect of DN sales can be found at Ofgem's website, www.ofgem.gov.uk

⁴ Ofgem's DISG meetings were held on a without prejudice basis. At these meetings it was made clear that any discussions occurring at DISG could not fetter the discretion of the Authority in respect of any issue associated with DN Sales. The minutes of the meetings can be found at Ofgem's website, www.ofgem.gov.uk

⁵ The net benefits were calculated in net present value terms over the period between 2005/6 and 2022/23.

⁶ Transco also applied for consents under Paragraph 3 of Schedule 3 to the Gas Act 1986 (the Gas Act) to permit it to dispose of land (relating to the four relevant gas networks) that it has acquired compulsorily, to the four relevant wholly owned subsidiary companies. The Authority consented to these applications at its meeting on 20 January 2005.

At the 20 January 2005 meeting, the Authority provided its conditional consent to Transco under ASC 29 of Transco's original GT licence in the terms described in Transco's four applications for consent, and the consents (along with documentation setting out the background and reasoning behind the Authority's decision) were published on Ofgem's website on 1 February 2005.⁷

The conditional consent was granted at a time when the details of the regulatory, commercial and operational arrangements necessary to protect the interests of customers in a divested industry structure were still being consulted upon and developed. The Authority therefore attached a number of conditions to its consent to ensure that it would be satisfied that the arrangements developed and implemented over the following months would protect the interests of customers and would be consistent with the Authority's principal objective and statutory and other public law duties.

The conditions to consent fall into two broad categories; conditions precedent,⁸ which must be satisfied before the proposed hive-down can occur, and conditions subsequent,⁹ which must be satisfied after hive-down occurs but before the proposed sale of the shares in the four relevant wholly owned subsidiary Transco companies to third party purchasers can occur. It should be noted that it is possible for the Authority to attach new conditions subsequent to address issues which arise before share sale.

The Authority's Consent Directions¹⁰ specify that if any of the conditions precedent are not satisfied by 1 May 2005, or if the Authority is of the opinion that any such condition is unlikely to be satisfied by that date, then the Authority is entitled to extend the period for satisfying the condition to an alternative date or waive or modify the condition.¹¹

2. Basis for Authority decision on conditions precedent

Today, at a duly convened meeting, the Authority considered, amongst other things, whether the conditions precedent have been satisfied and whether the proposed hive-down of Transco's four DN businesses into four wholly owned Transco subsidiary companies should be allowed to proceed.

In considering whether the conditions precedent have been satisfied, the Authority has had regard to the following key factors:

- ◆ its principal objective and statutory duties as set out in the Gas Act 1986;
- ◆ its public law duties; and
- ◆ the statutory and licence obligations of GTs, including Amended Standard Condition 9 (Network Code) (ASC 9) of Transco's original GT licence.

⁷ *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks Authority decision*, 1 February 2005, 21/05.

⁸ The Authority's conditions precedent are set out in paragraph 21 of the Authority's Consent Directions.

⁹ The Authority's conditions subsequent are set out in paragraph 23 of the Authority's Consent Directions.

¹⁰ A copy of the Authority's Consent Directions is contained in the February decision document.

¹¹ Authority's Consent Directions, as set out in paragraph 22.

The Authority also had regard to respondents' views.

The remainder of this letter gives details of each of the conditions precedent and sets out both Transco's and the Authority's view on whether the conditions have been met. The Transco view that is outlined in each section is based upon the assessment Transco provided to Ofgem on 18 April 2005.¹² Where relevant, this letter also sets out third party respondents' views on aspects of the issues addressed by the conditions.

3. Conditions precedent

Licence modification conditions

Paragraph 21(a) of the Consent Directions provides that Transco is not permitted to hive-down its DN assets into its four wholly owned subsidiary companies until it has consented to the modifications to its six GT licences¹³ as part of the initial section 23 licence modification process to separate out Transco's price controls¹⁴, and these modifications have become effective.

Paragraph 21(b) of the Consent Directions provides that Transco is not permitted to hive-down its DN assets until Transco has consented to the proposed section 8AA licence modifications in respect of the four proposed independent DNs (IDNs) (and related section 23 licence modifications in respect of the licences relating to Transco's National Transmission System (NTS) and retained DN businesses (RDNs) respectively) necessary to protect the interests of customers in a divested industry structure and these modifications have become effective.

Background

In the event of a DN sale, the licensing regime that Transco and each of its DN buyers must comply with in their role as GTs needs to be changed to ensure that it effectively supports a divested industry structure and that customers' interests are protected. These changes include modifications to existing licence conditions to reflect the divested industry structure, and also the introduction of new licence conditions to create obligations that are not currently present in Transco's GT licences to protect the interests of customers.

To give effect to these changes, Ofgem has issued a series of consultation documents regarding the modifications that need to be made to Transco's six GT licences as part of the

¹² *Update on progress regarding conditions precedent of the Authority's Consent Directions*, Transco, 18 April. This update was sent in response to an Ofgem open letter request dated 13 April, namely, *Gas Distribution Network Sales – Open letter to Transco requesting an update on progress regarding conditions precedent of the Authority's Consent Directions*, Ofgem, 13 April 2005.

¹³ In November 2004 (pursuant to applications from Transco in connection with DN sales), without fettering the Authority's discretion in relation to DN sales, five additional GT licences were granted to Transco. As a result, Transco currently holds six GT licences, five of which are revocable in the event that hive-down does not proceed. As at the date of this document Transco's original GT licence relates to the NTS only, one of the five additional GT licences relates to the DNs to be retained by Transco and each of the four other additional GT licences relate respectively to the four DNs to be disposed of by Transco.

¹⁴ *Modification of the price control conditions in each of Transco plc's six Gas Transporter licences*, Ofgem, 1 February 2005.

sales process (see below). Ofgem has also engaged in extensive discussions on the proposed changes through the DISG process.

In September 2004, Ofgem consulted in its Initial Thoughts document on the modifications to the six GT licences, in terms of both content and structure, which would be required to ensure that the regulatory framework to support a divested industry structure, and protect the interests of customers, would be in place following a DN sale.¹⁵ Following this, the Next Steps document¹⁶, published by Ofgem in November 2004, provided an opportunity for Ofgem to consult further on an informal basis and in light of the responses to the Initial Thoughts document in preparation for Ofgem's potential formal consultation on the modifications required to protect the interests of customers in a divested industry structure.

The Next Steps document also initiated a formal consultation to modify each of Transco's six GT licences under Section 23 of the Gas Act 1986 (Gas Act) to effectively separate the price controls between the six Transco GT licences. Following consideration of the responses received in relation to the Next Steps document, and having received Transco's written consent to these modifications, the Authority directed the modifications on 1 February 2005¹⁷ to separate the price controls between the six Transco GT licences, to come into effect on that date.

On 14 February 2005, Ofgem issued its formal consultation on the changes required to Transco's six GT licences under section 23 and section 8AA of the Gas Act (the February licence consultation).¹⁸ The consultation was twofold:

- ◆ the section 8AA consultation proposed to consent to the transfer of the four proposed IDN licences from Transco to four wholly-owned Transco subsidiary companies; and
- ◆ the section 8AA and section 23 consultations proposed to modify the four proposed IDN licences, and the NTS and RDN licences respectively. The NTS and RDN GT licences will continue to be held by Transco after DN sales. It should be noted that the original Transco GT licence will be the licence for its NTS activities.

Transco's view

In its letter to Ofgem of 18 April 2005, Transco noted that it had consented to the initial section 23 modifications relating to the separation of price controls on 31 January 2005 and that the Authority had directed the modifications on 1 February 2005 to come into effect on that date.

In terms of the section 8AA and section 23 modifications that formed the subject of the February licence consultation, Transco has indicated that it expects to be able to consent in writing to these modifications were the Authority to agree to direct.

¹⁵ *National Grid Transco – Potential Sale of gas distribution network businesses, Initial thoughts on restructuring Transco plc's Gas Transporter Licences, Consultation document, Ofgem, 2 September 2004* 215/04.

¹⁶ *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, Ofgem, 25 November 2004* 263/04

¹⁷ *Section 23 Direction: Modification of the price control conditions in each of Transco plc's six gas transporters licences, Ofgem, 1 February 2005.*

¹⁸ *National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986, Ofgem, 14 February 2005, 45/05.*

Respondents' views on the February licence consultation

Ofgem received seventeen responses to the February licence consultation. Responses were received from Transco, prospective DN purchasers, shippers/suppliers, the HSE, and the Association of Electricity Producers (AEP). These responses are summarised in Schedule 1 of both the Section 8AA Consent to Transfer and Direction and the Section 23 Direction published today¹⁹.

Transco and the potential DN purchasers were largely content with the licence modifications that Ofgem was proposing.

A number of shippers and the AEP had concerns regarding some of Ofgem's proposals. Key concerns included Ofgem's proposed licence conditions relating to the enduring offtake arrangements and to the reform to the interruption arrangements on the DNs.

Authority's view

The condition precedent set out in paragraph 21(a) of the Authority's Consent Directions was fulfilled on 1 February 2005 when the Authority issued its initial Section 23 direction following Transco providing its consent to the modifications on 31 January 2005.²⁰

The condition precedent set out in paragraph 21(b) of the Authority's Consent Directions relates to the February licence consultation²¹ in respect of which the consultation period closed on 15 April 2005.

The Authority noted the views of respondents on the licence conditions to introduce a best and reasonable endeavours obligation to introduce enduring offtake arrangements and DN interruption reform respectively. Whilst the Authority is mindful of these concerns, it considers that the proposed conditions are necessary to protect the interests of customers in a divested industry structure. For this reason it considered that these conditions should be implemented as consulted upon.

Following careful consideration of responses, the Authority has concluded that none of the issues raised in the section 8AA and related section 23 consultation require material changes to the licence drafting that would prevent the Authority from directing the modifications. The Authority has also concluded that the licence conditions are fit to allow hive-down to proceed. However, a number of corrections to cross references and minor typographical errors have been made to the proposed licence modifications consistent with the Gas Act. The Authority has therefore taken the decision to direct the relevant modifications, including the minor typographical changes, under section 8AA and section 23 of the Gas Act.²² These

¹⁹ *Consent to transfer four of the gas transporters licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986, Ofgem, 25 April 2005, and Modification to two of the six gas transporters licences held by Transco plc - Direction pursuant to section 23 of the Gas Act 1986, Ofgem, 25 April 2005.*

²⁰ *Section 23 Direction: Modification of the price control conditions in each of Transco plc's six gas transporters licences, Ofgem, 1 February 2005.*

²¹ *National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986, Ofgem, 14 February 2005, 45/05*

²² *Consent to transfer four of the gas transporters licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986, Ofgem, 25 April 2005, and Modification to*

modifications have been made today but will take effect by way of a separate direction which is expected to take place at 0600 hours on 1 May 2005 or such other date as the Authority may direct.

When they become effective, these directions will fulfil the condition precedent set out in the paragraph 21(b) of the Authority's Consent Directions. Further reasons for the Authority's decisions with respect to the condition precedent set out in paragraph 21 (b) can be found in the Section 8AA Consent to Transfer and Direction and the Section 23 Direction issued today.

Licence transfer conditions

Paragraph 21(c) of the Authority's Consent Directions provides that before hive-down can occur the Authority must have consented under section 8AA of the Gas Act to the transfer of the four GT licences relating to the proposed IDN businesses from Transco to each of its four relevant Transco wholly owned subsidiary companies respectively.

Transco's view

In its letter of 18 April 2005, Transco indicated that it expects the transfer of its licences in respect of the four IDNs to its four subsidiary companies to take effect on the appointed day²³ if the Authority consents to such a transfer occurring at the Authority's meeting on 25 April 2005.

Authority's view

As noted above, the Authority has today taken the decision to direct that the relevant modifications under section 8AA and section 23 of the Gas Act be made today but take effect on 1 May 2005 or such other later date that the Authority may direct. As part of this process, the Authority has also consented to the transfer of the four IDN GT licences from Transco to the four wholly owned Transco subsidiary companies expected on 1 May 2005 to allow hive-down to occur. As such, the condition precedent set out in the paragraph 21(c) of the Authority's Consent Directions is expected to be satisfied on 1 May 2005 or such later date as the Authority may direct.

Industry codes condition

Paragraph 21(d) of the Authority Consent Directions provides that, before hive-down can occur, the Authority must be satisfied as to the proposed arrangements for industry codes including (without limitation) the Uniform Network Code (UNC) arrangements and must have directed the implementation of Transco's proposed modification to its existing network code in order to create a short form network code that references the UNC.²⁴

Background

The commercial arrangements between Transco and shippers are currently set out in Transco's Network Code in accordance with ASC 9 of Transco's original GT licence. Transco's Network Code, developed in compliance with this requirement, is a contract

two of the six gas transporters licences held by Transco plc -Direction pursuant to section 23 of the Gas Act 1986, Ofgem, 25 April 2005.

²³ 1 May 2005

²⁴ The relevant modification proposal is Urgent Modification Proposal 0745, "Modification of the Network Code into Transco's individual (Short Form) Network Code".

between Transco and shippers which defines the rights and responsibilities attributed to all users of the Transco gas transportation system (both transmission and distribution).

The sale of four of Transco's DNs creates a requirement for the commercial arrangements, including the Network Code arrangements, to be restructured so that they can support a multi-transporter environment. Under the contractual framework proposed by Transco, Transco and each IDN would have its own "short form" network code (SFC) which would incorporate by reference the applicable terms of the UNC. Transco and each IDN would be jointly responsible for preparing the UNC which will set out, amongst other things, the transportation arrangements and modification rules except where the Authority consents otherwise.

Ofgem considered various aspects to the commercial and regulatory arrangements necessary to support a divested industry structure through its impact assessments and DISG meetings. Following these considerations, during the period between September 2004 and late February 2005, Transco has developed a UNC through a consultation process which has involved:

- ◆ the establishment of a working group, attended by shippers, potential purchasers and other interested parties, that reviewed Transco's proposed business rules relating to the UNC;
- ◆ the publication of a consultation document²⁵ which invited views from interested parties regarding the business rules to apply to each section of the UNC; and
- ◆ a series of legal drafting workshops, attended by shippers, potential purchasers and other interested parties, which discussed the changes that Transco proposed to make to create the UNC based on the text of its existing Network Code.²⁶

At the end of this process, Transco raised Urgent Modification Proposal 0745.²⁷ This modification proposal sought to modify Transco's Network Code by removing virtually all of its operative text, creating a short form code that incorporates the UNC by reference. On 25 February, the Authority granted urgent status to this modification proposal.²⁸

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.²⁹ The purpose of the network code consultation was to give interested parties the opportunity to comment on the UNC as drafted by Transco, as well as to provide them with an opportunity to comment in the round on all aspects of the Authority's future decisions, including:

²⁵ *Towards a new industry framework: A consultation by Transco*, Transco, December 2004. This document was followed by an update note which summarised responses and set out Transco's views on the issues raised.

²⁶ The associated papers are available on Transco's website. See <http://www.transco.co.uk/network%5Fsales/uncp.htm> and <http://www.transco.co.uk/network%5Fsales/erf.htm>.

²⁷ Transco Network Code Modification Proposal no. 0745 "Modification of the Network Code into Transco's individual ('Short Form') Network Code".

²⁸ Request for urgent status for modification proposal "Modification of the Network Code into Transco's individual ('Short Form') Network Code", Ofgem, 25 February 2005.

²⁹ *Gas Distribution Network Sales – Consultation on the Network Code Arrangements*, Ofgem open letter, 4 March 2005 and *Gas Distribution Network Sales – Stage 2 of the Consultation on the Network Code Arrangements*, Ofgem open letter, 29 March 2005.

- ◆ Transco's Urgent Modification Proposal 0745³⁰; and
- ◆ the proposed NTS and DN GT licence conditions which support the proposed commercial framework, specifically Standard Special Conditions A11, A12 and A15, as published in the February licence consultation.³¹

Ofgem's consultation on the network code arrangements was undertaken in two phases over a five week period. The first phase of consultation was undertaken over two weeks and completed on 18 March, following which Transco updated its UNC to reflect comments received from respondents. Subsequently, on 29 March, the second phase of the consultation commenced for a further two week period ending on 12 April. The purpose of this two phase consultation process was to ensure that respondents had an opportunity within an Ofgem consultation process to raise issues on the drafting of the UNC and help to shape the documentation.

On 18 April, Transco submitted its Final Modification Report to the Authority on Urgent Modification Proposal 0745. In addition, on 21 April 2005, Transco submitted to the Authority a request that it designate the four individual 'short-form' network codes in respect of Transco's four wholly owned subsidiary companies for the purposes of Standard Special Condition A11 of each Company's respective licence. Transco proposed that such designation would take effect from the date of hive-down. This request was submitted for the purpose of standard condition 3 of the gas shippers' licence and subject to Authority approval of Urgent Modification Proposal 0745.

Transco's view

In its letter to Ofgem of 18 April 2005,³² Transco indicated that it had considered the views expressed by respondents to the consultation on the network code arrangements, and had not identified any issues sufficiently material to warrant changing the UNC prior to hive-down.³³ Transco therefore considered that the UNC arrangements were sufficiently robust to support a divested industry structure following hive-down.

Transco has also outlined its view that Urgent Modification Proposal 0745 better facilitates the relevant objectives of Transco's Network Code as set out in ASC 9 of its original GT licence.³⁴ Transco considered that Ofgem's use of comparative regulation would create greater commercial incentives on Transco to operate their pipeline networks economically and efficiently. Transco also considered that the proposal would allow for consistency in the provision of transportation services to shippers and suppliers and, consequently, would facilitate effective competition.

³⁰ Transco submitted Urgent Modification Proposal 0745 to Ofgem on 23 February 2005. Ofgem granted urgency status on 25 February 2005. Urgent Modification Proposal 0745 was progressed in accordance with Transco's Network Code modification rules, parallel to the UNC consultation.

³¹ *National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986*, Ofgem, 14 February 2005, 45/05

³² *Update on process regarding conditions precedent of the Authority's Consent Directions*, Transco, 18 April 2005.

³³ In forming its view, Transco noted that if interested parties disagree with its assessment of the issues raised, they would have the opportunity to use the UNC modification procedures to address any residual concerns.

³⁴ *Urgent Modification Report, Modification of the Network Code into Transco's Individual ('Short Form') Network Code*, Modification Reference Number 0745, pg 6.

Respondents' views

Twelve responses were received in relation to Stage 1 of the network code arrangements consultation, and thirteen responses were received in relation to Stage 2. Responses were received from potential purchasers, shippers, Transco and Genserv. Annex 1 provides an overview of the key themes raised.

A significant number of comments were made regarding the process followed in relation to the network code consultation.³⁵ In particular, whilst some respondents considered that the consultation process had given them the opportunity to have all their concerns addressed, others considered that they had not had sufficient time to review the UNC, and consequently, they were concerned that unidentified problems may exist.

Respondents provided a number of comments in relation to the proposed UNC modification rules, including the role and composition of the modification panel. In addition, at Stage 1 of the consultation process, potential purchasers raised a number of issues which focussed on aspects of the relationship between Transco NTS and the DNs. Finally, one respondent expressed concerns in relation to the effectiveness of the drafting in relation to the transitional arrangements and the offtake arrangements.³⁶

Transco received twelve representations in relation to Urgent Modification Proposal 0745. Three respondents were supportive of the proposed modification, one respondent offered qualified support,³⁷ and seven respondents did not support the proposal. A number of respondents commented that it was not appropriate for the proposal to follow urgency procedures. A more detailed summary of responses is attached in Annex 1, and the points raised are considered in more detail in Ofgem's decision letter on Urgent Modification Proposal 0745.³⁸

Authority's view

Throughout the Authority's consideration of NGT's planned disposal of four of its DN businesses, the industry code arrangements have been a central issue.³⁹ This has involved the Authority seeking to ensure that the contractual framework is able to support a multi-transporter industry framework, and that the continuity of pre-existing industry contracts is maintained throughout the transaction so as to protect the interests of both present and future customers.

As part of this process, Ofgem has conducted extensive consultation on aspects of the commercial, regulatory and operational arrangements necessary to support a divested industry structure and protect the interests of customers including (but not limited to) changes to the governance and NTS offtake arrangements. These consultations, undertaken

³⁵ Both Transco and Ofgem responded to the process issues raised in stage 1 responses in open letters published on 29 March 2005. *Gas Distribution Network Sales – Stage 2 of the consultation on the network code arrangements*, Ofgem open letter, 29 March 2005 and *Gas Distribution Network Sales – Consultation on the network code arrangements*, Transco open letter, 29 March 2005.

³⁶ Transco subsequently provided reasons for why it considered that these concerns were unwarranted.

³⁷ The respondent withheld full support because they did not agree with the granting of urgent status to the modification proposal.

³⁸ Urgent Modification Proposal 0745 "Modification of the network code into Transco's individual (short form) network code", Ofgem decision letter, 25 April 2005.

³⁹ *National Grid Transco – Potential sale of distribution network businesses – A consultation document*, 77/03, Ofgem, July 2003.

through both the RIA and DISC processes, informed the Authority's decision in January 2005 to endorse the overall commercial, regulatory and operational framework necessary to support a divested industry structure and protect the interests of customers which was set out in Ofgem's Final IA. Since this time, Ofgem has also consulted extensively on the detail of the UNC arrangements in order to inform the Authority's decision on: the industry codes condition precedent; the industry code related aspects of the proposed NTS and DN GT licence modifications and Urgent Modification Proposal 0745.

In forming its decision regarding paragraph 21 (d) of its consent directions, the Authority has carefully considered views expressed by respondents to the network code arrangements consultation. The Authority has also carefully considered views expressed by respondents to the consultation on Urgent Modification Proposal 0745, and aspects of the February licence condition related to the industry codes.⁴⁰

The Authority acknowledges the concerns expressed by respondents in relation to the process associated with the development of the UNC. The Authority has also considered the issues raised by respondents regarding the substantive content of the UNC including (without limitation) those in relation to: the governance arrangements; transitional arrangements; the provisions relating to the transporter agency; the ability of transporters to appoint an agent to carry out their functions under the UNC; and the offtake arrangements.

The Authority also gave careful consideration to the responses it received from third parties highlighting concerns surrounding the process adopted for the development of the industry code arrangements. The Authority would note that Ofgem has conducted an extensive and inclusive consultation process on the issues surrounding NGT's planned DN sales over a period in excess of 22 months.

Within the context of NGT's proposed commercial transaction, when considering whether Transco had met the requirements of paragraph 21(d) of the Authority's Consent Directions it has been necessary to consider both whether the process has been substantively fair and open as well as the Authority's principal objective of protecting the interests of customers. In considering these matters, the Authority concluded that, whilst enhancements could have been made to the process associated with the industry code arrangements, Ofgem's consultation has been a fair and open process. The Authority therefore is satisfied that the process is sufficiently fair to proceed.

The Authority has also given careful consideration to the views of respondents on substantive issues of policy. In assessing these responses the Authority was mindful that the modification procedures (including provisions for urgent modifications and the consent to modify process) within the respective industry codes allow all signatories to these codes to raise modification proposals and for those proposals to be dealt with urgently as required. Given the flexibility of the governance arrangements, the Authority considered carefully whether there were any issues which were not capable of being addressed through modifications and was unable to identify any such issues from the responses received.

With regard to Urgent Modification Proposal 0745, the Authority has therefore determined that this modification proposal better facilitates the relevant objectives of Transco's original GT licence as set out in ASC 9. On 1 May 2005, or any such later date as the Authority may direct, Transco's existing network code will therefore become the NTS's and retained

⁴⁰ *National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986*, Ofgem, 14 February 2005, 45/05.

distribution businesses' short form code. The Authority has today issued a decision letter setting out its reasons for its decision.⁴¹

At its meeting the Authority also considered the request from Transco to designate the short form codes for each of the IDNs. The Authority has designated these codes to take effect from 1 May 2005, or any such other later date that the Authority shall direct.

Overall, the Authority has therefore formed the view that, having regard to its principal objective and wider statutory and public law duties, the condition precedent with regard to industry codes has been sufficiently satisfied to permit Transco to take the necessary steps towards proceeding to hive-down.

The HSE conditions

Paragraph 21(e) of the Authority's Consent Directions provides that prior to the consent to hive-down becoming effective the HSE must have received safety cases in respect of each of Transco's four relevant wholly owned subsidiary companies and in respect of Transco. It also provides that each of those safety cases must have been accepted by the HSE.

Transco's view

In its letter to Ofgem of 18 April, Transco indicated that the HSE has accepted the safety cases in respect of Transco's NTS and RDN businesses as well as for the four proposed IDN businesses. Transco also informed Ofgem that the HSE has completed its assessment of the safety case for the Scottish Independent Undertakings (SIUs) with full acceptance of this safety case expected prior to 1 May 2005.

Authority's view

The HSE has informed Ofgem that it has approved the safety cases necessary for hive-down to occur.⁴² Consequently, this condition precedent has been satisfied.

The Secretary of State conditions

Paragraph 21(f) of the Authority's Consent Directions states that, prior to the consent becoming effective, the Secretary of State must have granted her consent to the proposed hive-down of each of the four IDNs to each of the four relevant Transco wholly owned subsidiary companies and such consents must have unconditionally come into full effect.

The Secretary of State granted her consent to the proposed disposals on 27 January 2005,⁴³ and published a written ministerial statement to this effect on 2 February 2005.⁴⁴ Consequently, this condition precedent has been satisfied.

⁴¹ Urgent modification proposal 0745 "Modification of the network code into Transco's individual (short form) network code", Ofgem decision letter, 25 April 2005.

⁴² The HSE has also provided Ofgem with a copy of its confirmation letter sent to Transco and has confirmed that the approval of the SIU safety case should be in place by 1 May 2005.

⁴³ *Government go ahead for Gas Distribution Network Sales*, Department of Trade & Industry press release, 27 February 2005.

⁴⁴ *National Grid Transco – Potential Sale of Gas Distribution Networks: Statement of Reasons Following the Secretary of State's Decision*, Department of Trade and Industry, February 2005.

In addition, paragraph 21(g) of the Authority's Consent Directions states that prior to the consent becoming effective the Secretary of State has granted the proposed exemption under section 6A of the Gas Act to Transco's NTS business and the DNs in respect of the proposed offtake arrangements and that such an order must have come into full force and effect.

On 5 February 2005, the Gas Act 1986 (Exemption) (No. 2) Order 2005 granting such an exemption was made. It was laid before Parliament on 11 February 2005 and the exemption will come into full force and effect on 1 May 2005.⁴⁵

Transco's view

In its letter to Ofgem of 18 April 2005, Transco indicated that both conditions precedent contained in paragraphs 21(f) and (g) have been satisfied.

Authority's view

The Authority is satisfied that the conditions precedent set out in paragraphs 21(f) and (g) of the Authority's Consent Directions have been met in full.

The provision of undertakings conditions

Paragraph 21(h) of the Authority's Consent Directions provides that by 8 February 2005, Transco must have procured from NGT an undertaking addressed to the Authority, stating that NGT will:

- ◆ refrain from any action likely to cause Transco to breach any obligation under the direction or prevent Transco from taking appropriate steps to satisfy the conditions. This undertaking also applies to subsidiaries of NGT; and
- ◆ use its best endeavours to ensure that Transco takes steps to implement enduring offtake arrangements by 1 September 2005.

NGT provided this undertaking to the Authority on 2 February 2005.

In addition, paragraph 21(i) of the Authority's Consent Directions states that prior to the consent becoming effective by 1 March 2005, Transco must have procured from each of the Purchasers an undertaking addressed to the Authority, stating that the Purchaser will:

- ◆ refrain from any action likely to cause Transco to breach any obligation under the direction or prevent Transco from taking appropriate steps to satisfy the conditions. This undertaking also applies to subsidiaries of the Purchaser; and
- ◆ use its best endeavours to ensure that Transco takes steps to implement enduring offtake arrangements by 1 September 2005.

Following the Consent Directions, NGT requested such undertakings from the three potential purchasers (Gas Network Limited, Scotia Gas Networks plc, and MGN Gas

⁴⁵ There is one condition on this exemption, which provides that the Authority may direct the relevant GT to provide certain relevant information, and the GT must comply. The Authority has not yet made any such direction, though it may do so in the future. This condition, which is in favour of the Authority rather than the licensee, will not prevent the exemption coming into full force and effect on 1 May 2005.

Networks (UK) Limited), and undertakings from all three were received by Ofgem on 28 February 2005.

Transco's view

In its letter of 18 April 2005, Transco confirmed that the requisite undertakings have been provided to the Authority.

Authority's view

The Authority is satisfied that the conditions precedent contained in paragraphs of 21(h) and (i) of the Consent Directions have been met in full.

Other conditions precedent

Paragraph 21(j) of the Authority's Consent Directions states that prior to the consent becoming effective the proposed hive-down of the IDNs from Transco to each of the four relevant wholly owned Transco subsidiary companies must be consistent with all applicable conditions contained in the Original Transco Licence.

In addition, paragraph 21(k) of the Authority's Consent Directions states that prior to the consent becoming effective: all other consents, approvals et cetera relating to the hive-down of the four DNs to the four wholly owned subsidiary companies have been unconditionally obtained.

Transco's view

In its letter to Ofgem of 18 April 2005, Transco stated that it believes that the proposed hive-down of the IDNs is consistent with all applicable conditions contained within the original Transco GT licence.

Transco also indicated that it is currently in the process of requesting all the relevant consents identified as being necessary in respect of the Transco NTS, RDN and IDN licences such that they become effective from the appointed date of hive-down. Transco indicated that the majority of consents have already been requested and that it expected to submit any outstanding requests in the near future. Since this letter Transco has confirmed that Ofgem has now received all requests for consent to allow hive-down to proceed.

Authority's view

The Authority is satisfied that the conditions precedent contained in paragraph 21(j) have been satisfied.

In terms of consents, Transco has identified a number of cases where the Authority has, in the past, issued consents or approvals to Transco under the terms of its original GT licence. Transco has also identified circumstances where such consents and approvals will be required by the NTS and/or DN GT licensees after hive-down. Transco has requested that the Authority re-issue and grant, where applicable, such consents in relation to the NTS and grant consents requested in relation to the RDN licence and IDN licences so that such consents, directions, approvals will be in place on 1 May 2005. This will ensure that all licensees are compliant, such that the NTS, RDN and IDN licence holders will not be in breach of licence conditions immediately following hive-down.

The Authority is confident that those consents, directions and approvals which it has recommended be granted to the relevant licensees will be in place for 1 May 2005. However, Ofgem will be writing to Transco closer to the date of hive-down seeking Transco's confirmation that all such consents and approvals are in place.⁴⁶

4. Overall conclusion of Authority's views

For the reasons set out in this letter, the Authority has concluded that the conditions precedent have been or will be sufficiently satisfied to allow hive-down to occur on 1 May 2005. Therefore, the Authority, without fettering its discretion, has given Transco permission to take steps towards implementing hive-down of the four relevant DNs to the four wholly owned Transco subsidiary companies.

To this end, the Authority has today:

- ◆ directed the relevant modifications under section 8AA⁴⁷ and section 23⁴⁸ of the Gas Act be made today but shall take effect on 1 May 2005 or such other date as the Authority may direct⁴⁹;
- ◆ directed the implementation of Transco's Urgent Modification Proposal 0745, to take effect on 1 May 2005 or such other date as the Authority may direct;⁵⁰ and
- ◆ designated the short form codes for each of the IDNs to take effect on 1 May 2005 or such other date as the Authority may direct.

5. Way forward

A number of steps will need to be undertaken before Transco can proceed to hive-down of its four relevant DN businesses to its four wholly owned Transco subsidiary companies on 1 May 2005 or such other date as the Authority may direct.

Process preceding hive-down

In particular, prior to the Authority permitting hive-down to occur, Ofgem will write to Transco to seek Transco's final confirmation that all of the conditions precedent to hive-down have been satisfied in full including, in particular, the condition precedent relating to consents and approvals, namely paragraph 21(k) of the Authority's Consent Directions. Ofgem expects to issue this letter in the coming days. Transco's response to this letter will then be assessed by the Authority.

Final permission to undertake the disposal itself will not occur until the Authority has issued a further notice (the Implementation Direction) setting out that its conditions precedent have

⁴⁶ One consent exempt from revocation is the temporary derogation enabling Transco to enter into proposed confidentiality agreements with producers.

⁴⁷ Consent to transfer four of the GT licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986, Ofgem, 25 April 2005.

⁴⁸ Modification to two of the six GT licences held by Transco plc -direction pursuant to section 23 of the Gas Act 1986, Ofgem, 25 April 2005.

⁴⁹ Transfer of licences will also occur at that stage.

⁵⁰ Urgent Modification Proposal 0745 "Modification of the Network Code into Transco's individual (Short Form) Network Code", Ofgem decision letter, 25 April 2005.

been satisfied in full. The Authority expects to issue this notice immediately before the point of hive-down. Depending upon Transco's response, and without fettering its discretion, the Authority would expect to issue the Implementation Direction on Friday 29 April. Following this, hive-down would be expected to occur at 06:00 on Sunday 1 May 2005.

Conditions subsequent

Before Transco can complete the DN Sales process, further regulatory consents will be required. Without fettering the discretion of the Authority in future decisions, the Authority will also need to consider whether it is willing to consent to the sale of shares in Transco's four wholly owned subsidiary companies to the three potential third party purchasers. Any such approval will be subject to the fulfilment of the conditions subsequent to the consent granted in January 2005, which will be considered by the Authority following hive-down.

Paragraph 23(c) of the conditions subsequent states that Transco will need to provide its consent, and procure that each of its four relevant wholly owned subsidiary DN companies provide their consent, to any licence modifications following hive-down. In this respect, and as noted above, Ofgem intends to issue a further section 23 licence modification consultation shortly in relation to each of Transco's six relevant licences.

As noted above, this consultation will be in two parts:

- ◆ **Part A** will contain Ofgem's final proposals regarding the interim incentives that the NTS and DN GT licensees will be bound by until the end of September 2008; and
- ◆ **Part B** will contain the additional amendments identified as required following a potential DN sale.

Subject to consideration of views expressed by respondents, the Authority expects to direct the changes included within this section 23 notice to take effect from 1 June 2005, the proposed date of share sale. Prior to this date, the Authority will issue a letter stating whether it considers that the conditions subsequent have been met and therefore whether the sale of shares in the four DNs to the prospective purchasers can proceed.

Additional condition subsequent

At today's Authority meeting it was determined that an additional condition subsequent should be introduced to ensure that customers interests can be protected in a divested industry structure.

The new condition subsequent relates to the potential costs that may fall to customers associated with Transco's planned unconstrained release of incremental NTS offtake flexibility to the DNs (both IDNs and those continuing to be owned by Transco).

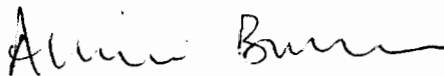
In Ofgem's Final IA it set out that Transco had stated that in the period prior to the introduction of the enduring offtake arrangements in 2008 interim arrangements would apply to allocate NTS offtake rights including NTS offtake flexibility. Transco had stated that to ensure that these offtake rights would be allocated on a non-discriminatory basis there would be an unconstrained release of capacity subject to its statutory and licence obligations. This means that any party that would be prepared to pay for the capacity would have the capacity allocated to that party and Transco would have to 'buy back' capacity from participants to manage any constraints on its system that might subsequently arise.

In developing these arrangements Transco had stated that it expected there to be no costs to customers associated with the introduction of the interim arrangements due to the unconstrained nature of its transmission system. Transco has however recently identified that there could be costs associated with the unconstrained incremental release of offtake flexibility.

Having considered these issues the Authority has determined to proceed with an unconstrained approach; however, to protect the interests of customers, the Authority has imposed a condition subsequent on its consent to Transco's applications to dispose of its relevant assets under ASC 29 of its original GT licence, the intent of which is to ensure that, overall, customers should not bear any of the costs associated with the unconstrained incremental release of NTS offtake flexibility for the interim period. Transco must satisfy the Authority that suitable arrangements are in place to achieve this objective by the time of share sale for the transaction to proceed to completion. The costs associated with any capacity buy backs relating to NTS flat or NTS exit capacity will remain to be incentivised as set out in Ofgem's initial proposals document.

If you have any questions about any of the issues addressed in this letter, please contact Sonia Brown (020 7901 7412) or Mark Feather (020 7901 7434), who would be happy to help.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Alistair Buchanan', with a stylized, cursive script.

ALISTAIR BUCHANAN
CHIEF EXECUTIVE OFFICER

Signed on behalf of the Authority and authorised for that purpose by the Authority

Annex 1 – Responses to the consultation on the network code arrangements

Respondents' views were received for both Stage 1 and Stage 2 of the consultation on the network code arrangements. This annex provides an overview of the key themes raised in responses, but does not attempt to present all views.

A detailed summary of issues raised in Stage 1 responses, and Transco's view of each issue, was prepared by Transco and submitted to Ofgem along with the revised version of the UNC on 29 March 2005.⁵¹ A detailed summary of issues raised in Stage 2 responses, and Transco's view of each issue, was prepared by Transco and submitted to Ofgem as part of its update on progress in meeting the conditions precedent dated 18 April 2005.⁵²

Stage 1 responses

Twelve responses were received in relation to Stage 1 of the UNC consultation. The following section provides an overview of the issues raised by respondents and details of the way in which these issues were addressed by Transco. It does not, however, provide a comprehensive summary of the issues that respondents identified.

A significant number of comments were made regarding the process followed in the network code consultation process. Both Transco and Ofgem responded to these issues in open letters published on 29 March 2005.⁵³

Transportation Principal Document

Two respondents considered that, in the same way that DNs would be permitted to apply for an increase in their amount of NTS offtake capacity, they should also be allowed to apply to the NTS for a decrease in offtake capacity. As a result, Transco amended the UNC to give DNs the opportunity to reduce NTS offtake capacities.

Some respondents expressed concern that DNs could be in breach of their Offtake Profile Notice (OPN), and as such subject to liabilities, in situations where the DN is complying with a request from the NTS, or where a DN received permission from the NTS to vary its offtake levels. In response to this concern, Transco amended the draft UNC to prevent the DNs from incurring liabilities in these circumstances. However, Transco clarified that the DNs (like Direct Connects) would still have a contractual commitment to ensure that gas offtaken from the NTS would not exceed or be less than the rate associated with the OPN by more than the appropriate tolerance.

One respondent was of the opinion that the flexibility tolerances should be redefined as 3% in order to be consistent with the provisions of the Offtake Arrangements Document. In response, Transco clarified the application of tolerances, stating that 1.5% provides an appropriate tolerance in the cumulative context in which it applies, and therefore proposed to leave the flexibility tolerance unchanged at 1.5%.

⁵¹ See the UNC Consultation Response Tables on the Gas Distribution Network Sales page of Ofgem's website, for example http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10905_02_CRT_TPD.pdf.

⁵² *Update on process regarding conditions precedent of the Authority's Consent Directions*, Transco, 18 April 2005.

⁵³ *Gas Distribution Network Sales – Stage 2 of the consultation on the network code arrangements*, Ofgem open letter, 29 March 2005 and *Gas Distribution Network Sales – Consultation on the network code arrangements*, Transco open letter, 29 March 2005.

Three respondents stated that they were unclear as to the way in which Transco intended to prioritise applications by users for increases in pressure of offtake from the NTS, and how these would be subsequently allocated. Transco responded by stating that any application would be considered in the context of the rules and in the context of its obligations not to be unduly discriminatory.

Three respondents questioned why certain sections relating to shrinkage scheduling had been removed from the draft proposals. Transco explained that these provisions were redundant because GTs are no longer permitted to procure gas at the beach.

Offtake Arrangements Document

Three respondents raised concerns in relation to the treatment of connections in Section B of the Offtake Arrangements Document. Such issues included, amongst others, the need for the NTS to compensate the DN for costs incurred where it failed to remove its equipment from a decommissioned offtake, as well as the removal of the provisions which permitted the NTS to disconnect a DN for reasons other than safety reasons. In response to these concerns, Transco made a number of changes to rebalance the relationship between the NTS and DNs with respect to connections.

Three respondents also set out that DNs should not be liable for NTS CV shrinkage costs which may arise as a result of failure of its CV measuring equipment. These respondents argued that their existing obligations would provide them with sufficient incentives to minimise such CV shrinkage costs. Transco agreed to remove the provision, with the caveat that if any indication of adverse performance became apparent, Transco would consider raising a modification proposal to reintroduce it.

Three respondents expressed concern regarding issues associated with the provisions incorporated in the UNC regarding maintenance, in particular the high number of flow relevant maintenance days allowed per offtake point and the NTS-led nature of the maintenance process. In response to these concerns, Transco implemented a number of amendments to reflect the collaborative nature of the maintenance arrangements and, in effect, to redress the balance of commercial advantages that had been attributed to the NTS.

Under the draft of the UNC published on 4 March 2005, if LDZ demand for any day was forecast to be less than 60% of 1 in 20 peak day demand, then Transco may require the DN to operate the LDZ flat. Three respondents considered the 60% threshold to be excessively high. In response, Transco agreed to change the threshold to 50%.

Two respondents stated that they were looking forward to seeing the Offtake Communications Document, and that they needed to do so in order to review detailed procedures against the provisions in the OAD. Transco noted that the Offtake Communications Document would capture existing information flows between Transco NTS and DNs, and subsequently made the document available on its website.

Modification Rules

A number of responses to Stage 1 of the network code consultation raised concerns regarding the proposed UNC modification rules. Four respondents objected to the reduction in the number of shipper representatives that would have a vote on the Panel on grounds that it would undermine Users' influence on the modification process. Two respondents proposed that an independent member, with a casting vote, should be elected

to the Panel. Five respondents stated that the introduction of a Panel recommendation at this stage was inappropriate and that changes to the modification process should not be progressed until after the outcome of the DTI appeals consultation is made public.

In response to these concerns, Transco reaffirmed its position that the implementation of a 5-5 panel structure⁵⁴ would better facilitate the relevant objectives. In relation to the issue of appointing an independent representative to the panel, Transco emphasised that positive recommendations would only be provided to the Authority in situations where a majority of the Panel favoured the modification proposal and that, where this was not achieved, the recommendation would be to reject the proposed modification. Transco also noted that the Panel structure was simply a proposed framework which would be implemented initially to support a divested industry structure and which would be reviewed once the outcome of the DTI's appeals process is known.

Three respondents stated that they did not support the use of Subject Matter Experts (SMEs), with one of these respondents stating that the relevant provisions were unduly complex. In a similar vein, two respondents considered that the related provisions, regarding the SME Code of Conduct, were unduly restrictive in prohibiting the SME from working on other issues. A further two respondents suggested that the SME Code of Conduct and Terms of Appointment should be developed in consultation with shippers.

Transco highlighted that it would be happy to consider the scope of the SME Code of Conduct with Users, and amended the UNC in order to make changes to the Code of Conduct and Terms of Appointment subject to Panel approval. Further, Transco relaxed terms of the SME Code of Conduct.

General comment on the UNC

Finally, two potential purchasers requested amendments to the UNC to make it clear that GTs may appoint an agent with respect to all activities to which it is a party and that, in carrying out these activities, the agent is able to have access to certain confidential information. Transco therefore inserted enabling modifications into the document to clarify that GTs may adopt an operating structure of this nature.

Stage 2 responses

Thirteen responses were received to Stage 2 of the consultation process. This summary does not seek to describe all issues raised in submissions, but rather provides a high level overview of the main points raised. Respondents raised issues in relation to both the process that had been followed and the content of the UNC.

Process Issues

Four respondents indicated that they were satisfied with the UNC development process. These respondents suggested that interested parties had been given the opportunity to provide comments and have their concerns addressed.

However, five respondents expressed dissatisfaction in relation to the process that had been followed. A key concern was that insufficient time had been allowed for consultation given the large volume of documents that respondents had been asked to review. As a result,

⁵⁴ A '5-5 panel structure' refers to a structure where the panel is composed of 5 GT representatives and 5 shipper representatives.

some respondents were concerned that there could be problems within the UNC that had not been identified as a result of the limited opportunities for review.

Two respondents suggested that the last minute changes to meeting schedules and other aspects of the process, including the late announcement of the two stage approach for the network code arrangements consultation, limited interested parties' ability to participate in the consultation process.

One respondent expressed concern that Transco had not made available various new ancillary documents associated with the UNC. Another respondent suggested that Transco had commenced the legal drafting process without finalising the business rules, and that this made it difficult to understand the baseline from which to review the legal text.

One respondent suggested that Transco introduced changes between Stage 1 & Stage 2 without adequate discussion or explanation, with the effect that shippers could be forced to adopt a document that they have not been able to fully review and with which they may not be satisfied.

Finally, one respondent suggested that, given the process problems, Ofgem should use the "consent to modify" process to address problems associated with the UNC which are discovered after the UNC is implemented.

Policy issues

In terms of policy issues raised in Stage 2 responses, a number of respondents focussed primarily on issues associated with the UNC modification rules.

Three respondents suggested that a modification panel constituted of five GT representatives and five User representatives would undermine Users' rights relative to the arrangements under the existing Transco Network Code. It was also suggested that the proposed governance arrangements went beyond the changes required to support a multi-transporter environment. Three respondents suggested that the proposed arrangements would slow down the modification process with the result that UNC governance would become less efficient. In response, Transco repeated its position as previously expressed.

One respondent objected to Transco's inclusion of a new paragraph which sets out that, where the panel is equally split in relation to an Authority recommendation, the recommendation to the Authority would be to reject the modification proposal. Transco expressed the view that the new paragraph represented a clarification of its proposals rather than a change.

Several respondents did not support the introduction of Subject Matter Experts to manage the modification development process. Some respondents suggested that the proposed arrangements were overly bureaucratic, whilst another considered that the arrangements required further thought and development. In response, Transco repeated its position as previously expressed, i.e. that the SME role provides an important opportunity for wider community involvement and demonstrable independence of the modification process.

One respondent suggested that the UNC was not comprehensive in its coverage of the services that were to be provided by the Agency. Transco responded by setting out its view that the relevant paragraph of the UNC discharges the GT licence obligation.

Another respondent suggested that, given that no charge is being levied on DNs for flexibility overruns, the formula for calculating overruns should not be included in the UNC drafting. In response, Transco stated that the flexibility product is defined by the overrun calculation and without it, the quantities specified in the Offtake Capacity Statement would have no meaning.