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13 June 2005

Dear Mr Tutton,

Notice of decision by the Gas and Electricity Markets Authority - Compliance with section 33BA of the Gas Act 1986

Following the Authority's consideration of the above matter, I am writing to notify you formally of the Authority's decision. This is outlined in the attached statement which will be published on the Ofgem website on 14 June 2005.

Yours sincerely

Sir Keith Stuart
For and on behalf of the Gas and Electricity Markets Authority

Statement by the Gas and Electricity markets Authority, following an investigation into compliance by Transco plc with its obligations under section 33BA of the Gas Act 1986

13 June 2005

1. Ofgem has conducted an investigation into Transco plc (Transco)'s compliance with section 33BA of the Gas Act 1986.
2. On 10 February 2004 Ofgem wrote to Transco indicating that information submitted by the company up to that point suggested that the company would fail 4 of the overall standards of performance (OS) determined for it under section 33BA(1) of the Gas Act 1986, and would be likely to fail one further standard. The letter further indicated that if, at the end of the year (31 March 2004), it transpired that Transco had indeed failed one or more of the OS, Ofgem would need to consider whether to recommend to the Gas and Electricity Markets Authority ("the Authority") that a financial penalty be imposed.
3. Between May 2004 and January 2005, Ofgem made enquiries of Transco, exchanged correspondence and held meetings to establish the position with regard to compliance with sections 33BA(1) and (3) of the Gas Act 1986.
4. At its meeting on 27 May 2005, the Authority considered the evidence collected and discussed the matter with senior management from Transco.

Evidence cited by Ofgem

5. Ofgem presented a report to the Authority which had been seen and commented upon by Transco prior to the meeting. The report summarised the legal background and went on to describe its investigation of the company's compliance.
6. It showed that Transco had reported a risk of failure against the OS in October 2003, and that the risk was attributed to the structural reorganisation of a key service provider, Fulcrum Connections Limited (Fulcrum). This reorganisation had been occasioned by changes to Transco's own administrative structure, and the creation of its Distribution Networks, which occurred on 1 April 2002.
7. Ofgem told the Authority that although its investigation had been triggered by statistical reports showing failure to reach the quantitative standards set by the Authority, it had requested, and had received, information regarding the way in which compliance with the OS had been managed within the relevant parts of Transco's business.

The Authority had been given, in Ofgem's report, a précis of the issues discussed with Transco at a meeting on 27 May 2004, which dealt with the reorganisation of Transco's networks and of Fulcrum.

8. Transco's written submission to the Authority included a chart showing the progress of the Fulcrum re-organisation and, in particular the introduction, in October 2003, of an initiative intended to clear backlogs of work which had arisen whilst this was going on.
9. Ofgem considered that, had Transco been managing its business in such a way as could reasonably be expected to meet the standards set for it, it should have been able to cater

for possible eventualities arising from the re-organisation of Fulcrum.

10. In any event, Ofgem's report to the Authority showed failures in excess of 20% against targets for 3 of the overall standards. The degree of percentage failure for the standards was such that it indicated a failure by Transco to conduct its business in such a way as could be reasonably expected to lead to it achieving them.

Transco's arguments

11. The arguments set out in Transco's written submission to the Authority, and voiced at the meeting, were that
 - Ofgem had presented no evidence or cogent argument to prove a breach of section 33BA(3) of the Gas Act 1986;
 - the extent of the breaches of the OS had been overstated because of misinterpretation of the Authority's determination in that respect; and
 - in view of the penalty imposed by the Authority in respect of breach of section 9 of the Gas Act 1986, further enforcement action on this occasion would be inappropriate.
12. Ofgem's responses to these points, seen by Transco prior to the meeting were that
 - the Gas Act provides for specific standards of performance to be set, and that it would be unsatisfactory if, in order for the Authority to take action in relation to failures, an in-depth examination of Transco's procedures was required – it was up to the company to decide how to run its business;
 - the investigating team considered that the extent of the failures to achieve the standards, and the Authority's previous findings in the section 9 case, were sufficient evidence of breach in this case;
 - Ofgem considered that its interpretation of the Authority's determination is correct, but that, even if Transco's figures were to be used, a significant failure to achieve the OS would still have occurred; and
 - Ofgem accepted the points made by Transco relating to overlap with the previous case but noted that any decision relating to penalty rested with the Authority.
13. Transco explained during the meeting that levels of demand for Fulcrum's services had been higher than forecast by both Transco and Ofgem at the time of the 2002 re-organisation, and submitted that it took remedial action in response to the deteriorating performance of Fulcrum.
14. Transco also said that the results of this remedial action took time to filter through, and that the action led to a long-term turnaround in Fulcrum's performance.
15. It had considered addressing the statistical failure by committing extra resource to dealing with new customer enquiries but not conducting a special exercise to clear backlogs, which represented cases where it had already failed the relevant standards. In practice it concluded that in view of the level of customer dissatisfaction in the backlog

cases, priority was given to dealing with these. Although the effect was to delay action on new enquiries, and to make statistical performance worse, it believed that this was the right thing to do for customers with long –standing complaints or enquiries.

16. The company had made a written observation that the issue to be proven was not whether it had failed to meet any OS (and if so by what margin), but whether or not it had conducted its business in such a way as could be reasonably be expected to achieve the standards. However, during the course of the meeting Transco acknowledged that there might be some level of performance which could, in itself, justifiably be attributed to such a failure.
17. Transco put forward an argument that the OS did not entirely match the expectations of all of its customer groups. In particular, those who were regular users of the connections process (e.g. shippers and suppliers), were attuned to the CSOS regime and did not expect, for example, to receive interim acknowledgements to correspondence under OS 4A.

The Authority's decision

18. The Authority accepts that a failure to achieve one or more of the OS will not, of itself, necessarily constitute a breach of the duty in section 33BA(3). However, as was accepted by Transco, a material breach, without mitigating circumstances, could do so.
19. The Authority notes that the reduction in connections work, which had been expected by Transco and Ofgem following the introduction of competition, did not materialise. However, the Authority considers that, since the rate by which, and the extent to which, competition would develop was uncertain, a prudent business would have had an appropriate contingency plan to address swiftly the problems which occurred in the deteriorating performance by Fulcrum.
20. Confidential
21. The Authority notes Transco's interpretation of the categories of consumer to whom the OS apply but does not agree with its view of the meaning, and considers that any divergence of view or ambiguity should have been raised when the OS were consulted upon in draft, and resolved at that time. It considers that, even on Transco's figures, the breach of certain of the standards was sufficiently material to justify the Authority in the absence of satisfactory explanations, finding that Transco was in breach of its duty under section 33BA(3) during the period 1 April 2003 to 31 March 2004.
22. The Authority recognises that performance against the OS did improve towards the end of the Year and that the actions taken by Transco have had a beneficial effect. For that reason, and in the light of the penalty previously imposed on Transco by the Authority for its breach of section 9(1)(a) of the Gas Act 1986, the Authority has decided not to impose a financial penalty for Transco's breach of section 33BA(3) of the Gas Act 1986.