



*Promoting choice and
value for all customers*

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22 February 2007

Dear Rob,

**Loss of supply due to third party damage and water ingress interruptions –
Letter of Understanding 2007-08**

Introduction

Under the previous gas distribution price control, we agreed compensation arrangements for payments to consumers who experience an interruption caused by third party damage or water ingress where their gas supply is not restored within 24 hours. These arrangements were agreed and implemented through a Letter of Understanding and a subsequent amendment (both letters attached at Annex A) which expire on 31 March 2007.

Ofgem is seeking confirmation from Scotland Gas Networks plc ("ScGN") that it agrees to extend these arrangements for the period from 1 April 2007 until 31 March 2008 (inclusive). The existing annual aggregate and incident liability caps have not been changed.

Please find below the revised version of the arrangements as discussed for third-party damage and water ingress interruptions.

**Arrangements for third-party damage and water ingress interruptions for the
period 1 April 2007 to 31 March 2008 (inclusive)**

Coverage

1. If the conveyance of gas to a domestic customer's premises is interrupted as a result of third-party damage to the Network (other than by ScGN's contractors working on ScGN property) or water ingress to the Network, ScGN shall restore their gas supply within 24 hours. If their supply is not restored within this time, ScGN shall make a payment of £30 to the customer affected. Further compensation of £30 will be paid for each additional period of 24 hours that the customer is off supply. The payment received by an individual customer is capped at £1,000.

2. If the conveyance of gas to a non-domestic customer's premises is interrupted as a result of third-party damage to the Network (other than ScGN's contractors working on ScGN property) or water ingress to the Network, ScGN shall restore their gas supply within 24 hours. If their supply is not restored within this time, ScGN shall make a fixed payment to the customer affected. A further fixed payment will be paid for each additional period of 24 hours the customer is off supply. The fixed payments shall be calculated in accordance with the Uniform Network Code provision for failure to make gas available for offtake.
3. "Network" shall mean property owned or operated by ScGN – including the pipe-line system, transportation system, pipe-line and transportation assets.
4. After an incident has occurred, ScGN will seek to reconnect customers with the same level of efficiency and timeliness regardless of the cause of the incident.
5. ScGN will assume the responsibility for coordinating the reconnection of all customers affected by an incident, including liaison with water companies and other relevant companies and agencies and, subject to 6 below, will procure and deploy CORGI registered contractors for work downstream of a customer's meter.
6. In the case of individual premises where water ingress to the Network has resulted in water entering the gas pipework downstream of the customer's meter, the relevant water company should contract with CORGI registered contractors, but ScGN must coordinate all remedial works in an efficient and timely fashion.
7. ScGN agrees for these arrangements to be implemented from 1 April 2007.

Exemptions from the above arrangements (Ofgem cannot exempt ScGN from any other legal right available to a customer in relation to an incident)

This letter:

8. Excludes liability absolutely in respect of an incident as a result of which more than 50,000 gas customers' premises are without supply.
9. Excludes liability absolutely where it was not reasonably practicable for ScGN to take the action required as a result of:
 - (a) industrial action by ScGN's employees; or
 - (b) the inability of ScGN to gain any necessary access to any premises; or
 - (c) the existence of circumstances by reason of which ScGN could reasonably expect that if it took the action it would be in breach of an enactment; or
 - (d) the effects of an event for which emergency regulations have been made under Part 2 of the Civil Contingencies Act 2004; or
 - (e) delays imposed by a requirement to obtain a permit for street works under the Traffic Management Act 2004; or
 - (f) any event caused by circumstances of an exceptional nature beyond the control of ScGN;and ScGN had taken all such steps as it was reasonable to take both to prevent the circumstances from occurring and to prevent them from having that effect.
10. Excludes liability absolutely if the interruption was caused by the customer's own action.
11. Excludes liability absolutely if ScGN has disconnected or refused to connect the customer's premises in exercise of a power under Schedule 2B to the Gas Act.

12. Excludes liability absolutely if the incident was caused by an act of terrorism, war, rebellion, insurrection, industrial disturbance, riots or civil commotion, or unlawful or malicious acts by a third party.

Annual aggregate and incident liability caps on payments to customers

13. The following table sets out the caps that will apply to each gas distribution network ("GDN") for each incident that gives rise to payments under paragraphs 1 and 2. It also sets out the limits for payments in aggregate per annum for each GDN.

Table 1 Annual aggregate and incident liability caps on payments

| | GDN | Incident cap | Aggregate cap |
|-----|------------------|--------------|---------------|
| NGG | East of England | £4m | £8.41m |
| | London | £4m | £5.01m |
| | North West | £4m | £6.01m |
| | West Midlands | £4m | £4.31m |
| NGN | North of England | £4m | £6.51m |
| SGN | Scotland | £4m | £5.09m |
| | South of England | £4m | £8.36m |
| WWU | Wales and West | £4m | £6.30m |

14. In the event of an incident that would or may be likely to cause one of the limits to be reached ScGN will discuss with the Authority the arrangements for allocating compensation to customers.

Information

15. ScGN will collect appropriately detailed information on each incident that occurs, including information on ScGN's performance in restoring gas supplies to customers. ScGN will provide quarterly reports as per Ofgem's guidance for reporting document, detailing incidents that have occurred in the previous year. The following information should be provided:

- the location of each incident, the number of customers' premises to which the gas supply has been affected, the cause of each incident, the time and date the incident started and details of the times and dates that gas supplies were restored;
- an aggregate summary of the incidents in the period;
- details of the payments made to customers; and
- details of payments that fell within the excess, where applicable.

Ofgem has previously expressed concerns with the costs of GDNs insuring against these events, particularly as the levels of the caps have reduced significantly compared with the previous arrangements.

We are currently reviewing the compensation arrangements for third party damage and water ingress interruptions as part of the main control, for the period 2008-13. We have sought views on an alternative approach for limiting GDNs liabilities for these types of interruptions, including the appropriate level of liability caps.

Please confirm your agreement of this Letter of Understanding by 23 March 2007. If you require any clarification with respect to these matters please contact Angela Bourke on the details above.

Yours sincerely

A handwritten signature in blue ink that reads "Joanna Whittington." The signature is written in a cursive style with a large initial 'J'.

Joanna Whittington
Director – Gas Distribution
Ofgem

Annex A

Paul Whittaker
Head of Regulation
Transco
31 Homer Road,
Solihull,
West Midlands,
B91 3LT

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Our Ref:
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17 June 2002

Dear Paul,

Loss of supply due to third-party damage (including water ingress) - Letter of Understanding

Introduction

Please find attached the revised version of the arrangements for third-party damage and water ingress interruptions. I have taken into account the fact that to the best of Transco's knowledge there have been no incidents in the past year due to industrial disturbances or unlawful or malicious acts by third-parties. We have therefore included these circumstances in the exemptions from the arrangements. However, please note that we would only expect Transco to claim these exemptions if circumstances arise that are materially different from those, which have occurred in the past.

It is also important that we continue to explore other avenues for formalising the arrangements for third-party and water ingress interruptions such as a licence modification. When equivalent arrangements are put into Transco's licence or Network Code, they will supersede the arrangements set out in this letter.

Arrangements for third-party damage and water ingress interruptions for the period 1 April 2002 to 31 March 2007 (inclusive)

Coverage:

1. If the conveyance of gas to a domestic customer is interrupted as a result of third-party damage to the Network (other than Transco's contractors working on Transco property) or water ingress to the Network, Transco shall restore their gas supply within 24 hours. If their supply is not restored within this time, Transco shall make a payment of £30 to the customer affected. Further compensation of £30 will be paid for each additional period of 24 hours that the customer is off supply. The payment received by an individual customer is capped at £1000.
2. If the conveyance of gas to a non-domestic customer is interrupted as a result of third-party damage to the Network (other than Transco's contractors working on Transco property) or water ingress to the Network, Transco shall restore their gas supply within 24 hours. If their supply is not restored within this time, Transco shall make a fixed payment to the customer

affected. A further fixed payment will be paid for each additional period of 24 hours the customer is off supply. The fixed payments shall be calculated in accordance with the Network Code provision for failure to make gas available for offtake.

3. Network shall mean Transco property – pipelines, pressure reduction stations/governors, terminals and compression stations.
4. After an incident has occurred, Transco will seek to reconnect customers with the same level of efficiency and timeliness regardless of the cause of the incident.
5. Transco will assume the responsibility for coordinating the reconnection of all customers affected by an incident, including liaison with water companies and other relevant companies and agencies and, subject to 6 below, will procure and deploy CORGI registered contractors for work downstream of a customer's meter.
6. In the case of individual premises where water ingress to the Network has resulted in water entering the gas pipework downstream of the customer's meter, the relevant water company should contract with CORGI registered contractors, but Transco must coordinate all remedial works in an efficient and timely fashion. In these circumstances, water companies should have regard to Section 209 of the Water Industry Act 1991.
7. Transco agrees for these arrangements to be implemented retrospectively from 1 April 2002.

Exemptions from the above arrangements (Ofgem cannot exempt Transco from any other legal right available to a customer in relation to an incident):

8. Excludes liability absolutely in respect of an incident as a result of which more than 50,000 gas customers' premises are without supply.
9. Excludes liability absolutely where it was not reasonably practicable for Transco to take the action required as a result of:
 - (a) industrial action by Transco's employees; or
 - (b) the inability of Transco to gain any necessary access to any premises; or
 - (c) the existence of circumstances by reason of which Transco could reasonably expect that if it took the action it would be in breach of an enactment; or
 - (d) any event caused by circumstances of an exceptional nature beyond the control of Transco;and Transco had taken all such steps as it was reasonable to take both to prevent the circumstances from occurring and to prevent them from having that effect.
10. Excludes liability absolutely if the interruption was caused by the customers' own action or if the customer committed an offence under the Gas Act.
11. Excludes liability absolutely if Transco has disconnected or refused to connect the customer's premises in exercise of a power under Schedule 2B to the Gas Act.
12. Excludes liability absolutely if the event was caused by an act of terrorism, war, rebellion, insurrection, industrial disturbance, riots or civil commotion, or unlawful or malicious acts by a third-party.

Aggregate Limits on payments to customers:

13. £20 million for each event that gives rise to payments under paragraphs 1 and 2 and £50 million annually in aggregate. In the event of an incident that would or may be likely to cause one of the limits to be reached Transco will discuss with the Authority the arrangements for allocating compensation to customers. In addition, if compensation in aggregate is made in excess of £20 million, Transco will discuss with the Authority its arrangements for making payments for the remainder of the period.

Excess:

14. Payments for incidents that fall into the insurance excess will form part of Transco's operating expenditure.

Premium:

15. Paragraph 3.85 in the September 2001 price control document sets out Ofgem's operating expenditure projections for third-party damage and water ingress interruptions for the period 1 April 2002 to 31 March 2007. This incorporates £1.63 million per annum to cover the cost of the insurance premia and a further £450,000 per annum to cover payments made by Transco during this period in respect of customers under the insurance excess.

Information:

16. Transco will collect appropriately detailed information on each incident that occurs, including information on Transco's performance in restoring gas supplies to customers, and provide reports by 30 April 2003 (and thereafter every 12 months), detailing incidents that have occurred in the previous year. The following information should be provided:

- ◆ the location of each incident, the number of customers' premises to which the gas supply has been affected, the cause of each incident, the time and date the incident started and details of the times and dates that gas supplies were restored;
- ◆ an aggregate summary of the incidents in the period;
- ◆ details of the payments made to customers; and
- ◆ details of payments that fell within the excess.

I hope that you will find the above acceptable and you will be able to confirm agreement as soon as possible. If you require any clarification with respect to these matters please contact Chris Watts (telephone 020 7901 7333).

Yours sincerely

Andrew Walker
Director – Regulation & Financial Affairs

Tim Tutton
Director of Regulation
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1 May 2005

Dear Tim,

Loss of supply due to third-party damage and water ingress interruptions – amendment to original Letter of Understanding (2002)

As you will be aware, Ofgem and Transco agreed compensation arrangements for interruptions to supplies caused by third party damage or water ingress in 2002 as part of the last price control review. These arrangements are set out in the Letter of Understanding from Andrew Walker to Paul Whittaker dated 17 June 2002 (enclosed). In the light of changes in the industry structure as a result of the Distribution Network ("DN") Sales process, you have brought to our attention the need for these arrangements to be amended.

It is important that comparable arrangements are put in place in each DN separately going forward. As such, the existing incident caps and annual aggregate caps on liabilities for Transco as a whole will no longer apply. Instead they will be replaced by separate incident caps and annual aggregate caps for each DN.

The following table sets out the caps that will apply for DN for each event that gives rise to payments under paragraphs 1 and 2 of the existing Letter of Understanding. It also sets out the limits for payments in aggregate per annum for each DN.

| Distribution Network | Payment cap for individual incident | Payment cap in aggregate annually |
|----------------------|-------------------------------------|-----------------------------------|
| East of England | £4m | £8.41m |
| London | £4m | £5.01m |
| North West | £4m | £6.01m |
| West Midlands | £4m | £4.31m |
| Scotland | £4m | £5.09m |
| South | £4m | £8.36m |
| North | £4m | £6.51m |
| Wales and West | £4m | £6.30m |

There will also be the following additional amendments to the arrangements to reflect the new Electricity (Standards of Performance) Regulations 2005 and changes arising from DN Sales:

- Reference to the "Network Code" should be replaced with reference to the "Unified Network Code"
- "Network" shall mean the DN's property – pipelines, pressure reduction stations and governors.
- An additional exemption should be inserted in the list in paragraph 9 – "the effects of an event for which emergency regulations have been made under Part 2 of the Civil Contingencies Act 2004"

Ofgem is concerned with the levels of premium currently being paid (and quoted for) for insuring against these events, particularly as the levels of the caps have reduced significantly compared with the existing arrangements. It will be important that these are reviewed as part of the next gas distribution price control.

These revised arrangements take effect from 1 May 2005. If you have any further questions, please feel free to get in touch with me.

Yours sincerely,

Joanna Whittington
Director – Gas Distribution