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Our Ref: I:\energy\gas\johnm\lattice

Dear Sirs

RE: Proposed Merger of National Grid Group plc and Lattice Group plc to create National Grid Transco plc

Thank you for the opportunity to comment on OFGEM's recent Consultation document "Proposed merger of National Grid Group plc and Lattice Group plc to create National Grid Transco plc". Our response is as an industrial consumer of both natural gas and electricity.

1. Consultation process

We note that OFGEM has drawn a distinction in its consultation between competition and regulatory aspects of the proposed merger and also that OFGEM will issue a separate consultation in the next few months on regulatory aspects of the transaction in the event it proceeds. In this event, please treat our response as our initial thoughts on the issues, as we may wish to make a supplementary response on the regulatory aspects of the proposed merger at a later date.

2. Competition aspects of the proposed merger

a) National Grid and Transco as competitors

In the consultation section on competition issues (page 9, paragraph 5.6), there is the statement "... it is OFGEM's initial view that NGC and Transco are not in direct competition with each other given that the networks deliver substantially different products." We would, however, take the view that both are about transmitting energy long distances and therefore there is some element of competition. In the event that the proposed merger is permitted by UK regulatory authorities, there is the obvious danger that National Grid transco plc may have a future vested interest (for example, on a regional basis) in seeking to

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promote the use of one energy source at the expense of the other (through differential charges or charging mechanisms) if National Grid Transco decides that one transporting one form of energy is likely to provide it with better returns or be less risky.

b) Potential loss of innovation/competition

Another potential negative aspect of the proposed merger is that there will be a potential loss of innovation and competition from one company (for example the National Grid) seeking to grow its business at the expense of the other company (in this example, Lattice/Transco). A combined organisation such as National Grid Transco will not have similar long term incentives to grow the market for "their" particular energy source/ or "their" particular transportation business,

3. Regulatory aspects of the proposed merger

a) Merger Cost Savings

According to OFGEM's consultation document, National Grid Transco will be able to make "significant operational synergies" in addition to annual efficiency savings at £100m pa. The new company may be also able to benefit from a reduced cost of capital in the event that the merger is approved. As a result we believe that OFGEM should insist, on behalf of customers, that first part of any merger synergies should be for the benefit of customers rather than shareholders. In order to achieve this objective, OFGEM may wish to seek Transco's/Lattice plc agreement to an appropriate tightening in Transco's 2002-7 price control before finalisation.

b) Potential conflicts of interest

OFGEM may consider that National Grid Transco's operation of EnMo and its operation of CHP plant represent potential conflicts of interest with the main (prospective) business as a combined natural gas and electricity transportation company. If it determines that these non-core activities are potential conflicts of interest, OFGEM may wish to require that these interests are sold.

c) Combined System Operator role

The consultation document points out that the proposed combined company (National Grid Transco) would act as system operator in both the electricity and natural gas markets. Currently both National Grid and Transco seek to balance supply and demand on a least cost basis in their respective markets. In contrast, a merged National Grid Transco plc may reasonably seek to minimise total natural gas and

electricity balancing costs as a whole. Although this may bring customer benefits overall, there is the danger that individual market participants (or groups of market participants) may be **disadvantaged** by behavioural changes in **Transco's/National Grid** Transco's propensity to interrupt different **types of natural gas** customer in order to maximise the combined company's profitability.

d) Potential diversion of **management resources**

We agree with **OFGEM's** concerns that the proposed merger between National Grid and Lattice could lead to a re-direction of key management attention to the development overseas **business** interests. This may lead to the remaining management of the UK business taking their eye off the ball. Our view is that National Grid **Transco's** main focus as a company should be to provide UK energy customers with safe, reliable, efficient and internationally competitive transportation networks for both **electricity** and natural gas. As a result **OFGEM** may wish to seek written assurances that key UK senior management executives will not re-directed to existing or prospective **overseas** business interests.

e) Access to information

In its role as a **system** operator in both the **electricity** and natural gas markets, National Grid Transco would be in a **very** privileged position in terms of its access to natural gas/electricity market information. As **OFGEM** is aware, there is a current problem of the differential access of market participants to market information (eg power station availabilities, daily natural gas **linepack** Information, natural gas storage injections and withdrawals etc). In the context of the proposed merger, we would suggest that **OFGEM** has the opportunity, should it wish to **use** it, of seeking to gain the commitment of National Grid Transco to commit to the timely publication to all market participants of **OFGEM's** own "wish-list" of market information as a condition of its approval to the proposed merger.

f) **Harmonisation of Grid Code/Network Code**

An issue arising from the proposed merger is that the new company may seek to **harmonise CUSC** and the Network Code as they apply in practical terms to customers. For example NGC require signed Connection agreements for all customers directly connected to its system, whereas Transco does not. Any **harmonisation** done should clearly help **customers** and not be used to **foist** the worst **aspects of the** separate companies' commercial and legal **requirements** on captive end-users.

Page 4 of 4

In the event that you have queries on our submission please call me.

Yours faithfully,



\John Mathers

Manager, UK Energy Contracts