TOTAL GAS & POWER LIMITED

Mr K Hanks
Director, Gas Trading Arrangements
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

26th September 2003

Dear Kyran,

RE: **National Grid Transco – Potential sale of network distribution businesses**

Total Gas & Power Limited (Total) thank you for the opportunity to comment on the above consultation document. With regards to the specific areas that Ofgem have asked for comment, we have addressed these issues in the Appendix.

We recognise that considerable effort has been expended on developing these proposals. However, Total is disappointed not to have been involved at an earlier stage. We believe that there are many issues yet to be identified or considered at this point. We are willing to engage in constructive discussion on issues surrounding the possible sale of a Distribution Network (DN). Further, we remain to be convinced on the benefits associated with a sale of a DN.

This consultation document should be the first step in a process. Although it is envisaged that GEMA will make a decision as to whether to grant a sale of a DN in November, we feel that this should still be provisional, and should not suggest a definitive approval that NGT can proceed in a DN sale. GEMA's decision will affect the entire gas industry. The issues may not be sufficiently developed to grant a disposal of a DN at this time.

Total feel that the best method in which to proceed is to allow the industry to consult directly on the Regulatory Impact Assessment (RIA), in order to analyse the costs and benefits that will arise if a DN sale occurs. Although the document has provided a RIA, the methodology on which this was constructed has not been made available, and as such we consider greater clarity is required on this issue.

There are several issues that a robust and methodical RIA should include. The resource allocation that the industry, Ofgem and GEMA will have to expend in the short term, in developing the framework, and the long term, in monitoring DNs that are sold and retained by NGT must be included. We believe that this could be a significant cost. In the same light, resources may be diverted from elsewhere in the industry, hindering the development of other changes in the regime, such as the exit and interruption regime. The RIA methodology must be able to take account of opportunity costs that could arise.

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The costs and benefits from other regime changes must not be *"double counted"* in the RIA. It was made clear at Ofgem's workshop held on the 10th September that the exit review would continue regardless of whether consent to a DN sale is granted. It is imperative that the RIA distinguishes costs and benefits that arise directly from a DN sale, exit and interruption regime, Supply Point Administration Arrangements (SPAA) and other regime changes.

Further, the RIA must ensure that it does not include costs and benefits that arise directly from the imposition of separate price controls, the final proposals of which were only published a month before this consultation. A conclusion from the June 2003 consultation was that under separate price controls, it was still possible for the DNs to benefit from economies of scale and scope. However, given the sale of a DN and its separation from the NGT group, there would be a loss of economies of scale. It is essential that the RIA methodology take account of these costs.

At this stage, Total is concerned with the Gateway approach. Although we understand that NGT wish to make progress with a sale of one or more of their DNs by September next year, we feel that this approach may not be completely appropriate. We feel that Ofgem should implement a clear project management strategy, identifying key milestones and deliverables in order to focus the industry on developing the correct framework. Upon reaching a milestone or deliverable, the RIA should be updated and presented to the industry, providing certainty that the process is developing appropriately.

Another uncertainty that Total has at present concerns the agency arrangements. Alternatives must be investigated, as this may highlight the best solution. For example, if sufficiently strict incentives were to be placed on each DN, this may encourage the DN to procure and outsource services efficiently.

We prefer to seek arrangements that are simple, with cost minimisation being a key driver, as high costs will inevitably be borne by consumers. However, the RIA should take account of the possibility that even simple arrangements evolve into complex ones. The RIA needs to be mindful of this, with the introduction of tolerances to take account of the costs and benefits that could arise through the evolutionary process.

Further, an underlying principle that must be maintained, regardless of which arrangements are established to facilitate a DN sale, is to ensure that there is no loss of service standards, both to shippers and consumers. Any loss will be unfavourable to many groups, and be a retrograde step for the Gas Industry.

The framework that exists if a DN is sold must not lead to the benefits that have been proposed to date from incremental changes, such as from the Revised Gas Metering Arrangements (RGMA), being reduced.

We realise that considerable effort will be made by Ofgem and NGT in the development of a framework that will yield benefit to consumers should a DN sale occur. However, the possibility arises that the benefits that the RIA envisaged will not come to fruition. Therefore, NGT should be incentivised to deliver in full the benefits to consumers, whilst retaining its own benefits from the sale.

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Should NGT sell a DN, a significant transformation not seen since the introduction of the Network Code will occur in the UK Gas Industry. With this in mind, and to summarise our recommendations, we believe that a robust process must be developed which highlights the key deliverables and milestones. When any of the milestones or deliverables are met, the RIA should be updated and presented to the industry and authority for comment to ensure that there is no detrimental affect. Should it be foreseen that there are any significant changes to the initial benefits, a sale should be reassessed, as to continue would only satisfy NGT's objectives.

Should you wish to discuss further any of the points raised in our response, then please contact me using any of the details below.

Yours sincerely

(This letter is sent electronically and therefore is not signed)

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APPENDIX

Regulatory Architecture

Total prefer the adoption of a simple approach, hence at this stage are in favour of a Uniform Network Code (UNC). However, if this framework is adopted, there are several issues that must be taken into account in its development. Costs to the industry must be kept to a minimum, as these costs will inevitably be passed to the consumer. Nevertheless, we understand that the best approach may not necessarily lead to the least cost solution. The RIA methodology should take this into account.

The UNC should aim not to have damaging affects on supplier competition. Our experience of supplying customers who are on Independent Gas Transporters (IGTs) networks illustrates that supplier competition is reduced. This is due to the fact that IGTs are not under NGT's network code, and hence have different terms, conditions and pricing methodologies. This leads to shippers experiencing higher transaction costs, which in turn has lead to a reduction in competition to consumers who are supplied through these networks. A solution could be to introduce an UNC that include standard terms, conditions and pricing methodology.

Total has further concerns that the regulatory architecture that is implemented could be administered behind a *"closed door"*, despite a requirement for minimal change. If a DN is sold, its owner, as well as NGT, must have transparent and accountable regulatory controls upon which the industry can comment and modify.

Finally, the regulatory structure must ensure that the evolution of the gas industry is not hindered, as this will be detrimental to the consumer in the long term.

Impact and options for exit and interruptions regime

Total recognises that a problem exists in the exit and interruption regime. There are clear benefits, and its development will continue regardless of a DN sale.

However, what benefits will occur from a DN sale over and above that which will occur given a sale does not take place? This issue requires clarification.

The RIA methodology must be able to take account of the above as well as the possibility that a sale may be more of an obstruction rather than facilitating the regime's development.

Impact and options for gas balancing

Total prefers that there be minimal impact on gas balancing. Although we do not have a preference as to which is utilised at present, whichever method is undertaken should protect the NBP and OCM markets. The liquidity of the NBP is one of the most important features that has lead to competition in the wholesale market for gas, which has in turn facilitated price transparency to consumers, particularly the Industrial & Commercial sector. Furthermore, commercial arrangements and security of supply must not be detrimentally affected.

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We remain to be convinced that linepack pricing is a necessity for a DN sale. Past experience has shown that it has been difficult to articulate an efficient and effective linepack pricing regime.

Impact on Supply Point Administration

Upon examining the manner in which a DN sale may affect the SPAA and the customer transfer process, any change must ensure that the progress made to date is not jeopardised. As discussed previously, if a DN sale were to defer the implementation date for these projects, any associated loss of benefits must be included in the RIA. Ofgem should also be able to offer a clear explanation to all stakeholders as to why it was necessary to delay such projects.

The RIA should include analysis of any likely changes to customer transfer transaction costs. If a sale were to go ahead, and shippers were required to deal with several DNs, the replication of information systems, data flows, reconciliations and so on will raise costs. Although we understand the introduction of agency arrangements may reduce these duplications, shippers would still have to interface with both NGT and the Agent, which would delay query resolution.

We have concerns that the current transaction costs may be higher for the electricity than for the gas industry, mainly due to the additional structural complexity that the electricity industry encompasses. We note NGT's preference for simplicity but believe there is a risk that this will not be maintained in the medium to long term which again needs to be factored into the RIA.

The solution mentioned in the consultation favours an agency approach. However, as mentioned earlier, alternatives must be investigated in order to obtain the best approach.

We have concerns that there is a possibility that costs may spiral. Again, this should be taken into account when assessing the viability of a DN sale, and we feel as though the best manner in which to take account of these issues is to consult the industry by way of RIA.

A further issue to be taken into account is the method in which Transco could obtain services through the market, whether it is by tender or any other method. It may be the case that the agency is set certain procurement guidelines. If this type of method is implemented, it may be the case that the agency's activities require regulatory scrutiny. This is another cost to the industry that a RIA consultation will highlight.

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