

Gas Forum Response to Ofgem

Sonia Brown
Director, Transportation
Ofgem

Dear Sonia,

16th December 2004

National Grid Transco – Potential sale of gas distribution network businesses Final Impact Assessment

I write on behalf of the Gas Forum in response to your Final Impact Assessment (IA).

The Gas Forum represents all of the major shippers and suppliers in UK and our members will no doubt be expressing their views individually. Whilst the Gas Forum cannot speak for all of its members when expressing a view as to whether DN sales should be allowed to proceed, the majority of our members cannot support the "sale" option at this time. However the concerns expressed below about certain aspects of the IA, particularly with regard to exit and flexibility, are the majority views of our members.

Exit & Flexibility

Ofgem has highlighted the need to ensure that Transco cannot act in an unduly discriminatory manner when allocating exit capacity and flexibility between retained DNs, independent DNs and customers directly connected to the NTS. Whilst Forum members share this concern, we do not believe that Ofgem has adequately explained why existing licence obligations would fail to provide the necessary safeguards going forward. We believe they could easily be enhanced with simple business separation measures and audit provisions. We believe Ofgem's proposed approach is disproportionately complex and will result in significant and unnecessary risk and cost.

Reform of exit and the introduction of the flexibility mechanism have also been justified on the basis of concerns by NGT that new DN owners might operate their systems in a different manner, causing operational difficulties. NGT has failed to explain under what circumstances this might arise or presented any evidence on materiality. Such concerns are currently dealt with in gas and electricity through formal rule based mechanisms. Forum members do not understand why this would not work going forward. We believe the proposed flexibility mechanism is unnecessarily complicated and will result in significant and unnecessary additional risk and cost.

The Gas Forum is concerned that the full impact of a commercial booking arrangement for capacity and flexibility has not been properly assessed, particularly in relation to impact on;

- The electricity market,
- The balancing mechanism,
- Security of supply for both gas and electricity, and,
- Storage.

There may also be implications under the Financial Services Act. The proposed model relies on shippers booking exit capacity and flexibility on behalf of NTS

customers. Forum members believe they will not be able to advise customers on how and when to buy capacity and flexibility. This represents a significant change in arrangements for customers. We do not believe this has been fully considered or explained to customers.

The Forum has on many occasions raised its concerns that Ofgem has attached exit, offtake and flexibility arrangements to the DN Sale work. We had understood that any changes in exit and offtake arrangements would be progressed through normal Network Code processes as the Authority outlined in its decision documents on this subject.

The Forum remains firmly of the view that this work should be de-coupled from the DN sale. Existing arrangements should be allowed to continue with simple rule based mechanisms dealing with the NTS / DN interface. If necessary, further reform could then be implemented following any sale, once the full impact has been considered. In this way more appropriate and proportional solutions could be developed.

Comparative Regulation

In its "Separation of Transco's distribution price control - Final Proposals" paper (June 2003) Ofgem was clear that the introduction of separate price controls for each DN would have the advantages of introducing;

- "opportunities to compare the performance of regional networks and so enable more effective regulation; and,
- the creation of greater management focus and promote savings which can be shared with consumers."

In the present IA 95% of the base case benefits of £225 million in present value terms are estimated to be derived from the introduction of comparative regulation.

A significant proportion of these savings could have accrued through the introduction of separate price controls, without any sale. The Forum therefore believes that to avoid "double counting" this proportion should be assessed and excluded from the benefits of the sale option as they could be expected to be applicable under either scenario. The additional savings from a change of ownership should then be used in determining further benefits under the sale case.

Process

The Gas Forum is concerned about some of the processes adopted by Ofgem in progressing this project. On occasions decisions appear to have been made between NGT and Ofgem and later presented to the industry as decisions rather than proposals for open consultation. This is not in keeping with the Authority's responsibilities under the Act to have regard for best regulatory practice and we would welcome the Authority's views on this.

Published plans remain at a very high level of detail and are inadequate for practical purposes and interdependencies between activities are not well understood. Members are unable to plan for, develop or implement changes to business processes or computer systems given the lack of detailed information on the post-sale arrangements.

The introduction of the planned Unified Network Code (UNC) is in effect a major modification to the existing Network Code. The Forum therefore believes that existing

governance arrangements should have been used and that the adopted approach has no standing or foundation.

There has been no industry agreement on future governance arrangements for the UNC and there is no document of how Ofgem understands NGTs proposals will work. The Forum has put considerable effort into reviewing and making proposals to improve the governance of the Network Code in light of experience of its workings. We would expect such changes to be carried forward into the UNC.

Experience of members attending DISG meetings is that information is presented and if consultation takes place at all it is over the course of the meeting and/or a few days before and after. This is unsatisfactory and not in keeping with Ofgem's own guidelines nor those of the Cabinet Office. Topics for discussion at meetings have been frequently represented by NGT as "agreed by DISG" despite shippers persistent correction that this group does not have the power to make such policy decisions. It cannot be viewed as, nor has it acted as, a satisfactory replacement to proper consultation.

Costings

The Gas Forum is concerned that the benefit of a sale may have been overestimated since "no sale" has been regarded as "no change". In practice continuing evolution of the regime (e.g. separate DN price controls) would deliver some of the benefits claimed for the sale, albeit at a slower pace. On the other hand some areas of likely cost directly attributable to the sale are inadequately considered or have been discounted by Ofgem. For example the proposed flexibility arrangements were not defined or sufficiently understood by shippers when cost proformas were submitted. We believe this represents an area of considerable additional and unnecessary cost that has not been adequately taken into account. The impact of disjointed metering arrangements, and the cost of securing separate credit arrangements are other examples.

I must express the concerns of members at the short time now available to implement what we believe in some cases to be unnecessary, unjustified and complex changes (particularly in relation to the flexibility product) and proposals have yet to be agreed in detail.

There is insufficient time to consider and implement changes to business processes and computer systems and we remain concerned that the project is overly complicated by the addition of the exit / flexibility arrangements. The additional risk and cost associated with these arrangements can only diminish any benefits associated with a DN sale.

We continue to be of the view that reform of exit and flexibility should be decoupled from the project at this point. Greater consideration could be given to such areas of reform following any sale, should they be proven to be necessary. Appropriate measures could then be developed and implemented to minimise risk and additional cost to all industry participants, particularly customers and secure maximum benefit.

Finally we would request that all future consultations of this magnitude are given more time for review, to allow our members adequate opportunity to consider their positions

Yours,

ANGELA LOVE

Chairman Gas Forum