



Shippers, National Grid Transco and other interested parties

Direct Dial: 020 7901 7357  
25 April 2005  
Our Ref: IND/COD/MOD/0745

Dear Colleague,

**Urgent Modification Proposal 0745 “Modification of the Network Code into Transco's individual (short form) network code”**

Having carefully considered the issues raised by Urgent Modification Proposal 0745 and respondents' views, the Authority<sup>1</sup> has decided to direct Transco plc (“Transco”) to implement the proposal from 1 May 2005 (or such later date as the Authority may direct) as the Authority considers that it better facilitates the code relevant objectives as set out in Amended Standard Condition (ASC) 9 of Transco's original Gas Transporters (GT) licence. In this letter, Ofgem provides some background to the Proposal and explains the reasons for reaching this decision.

**Background to the Proposal**

*Proposed sale of Transco's gas distribution networks (DNs)*

In May 2003, National Grid Transco plc (NGT) announced that it would consider the sale of one or more of its DN's if such a transaction was to maximise shareholder value. Any such sale would represent a fundamental change to the structure of the gas industry and would require the consent of the Authority under ASC 29 of Transco's original GT licence as well as consent from the Secretary of State for Trade and Industry. In addition, safety cases under the gas safety (management) Regulations 1996 (GS(M)R) would need to be accepted by the Health and Safety Executive (HSE).

Following NGT's announcement, Ofgem undertook a significant programme of work and consultation to investigate the potential costs and benefits that such a transaction could deliver for customers<sup>2</sup>. This process has included the establishment of a number of industry workgroups, including the Development and Implementation Steering Group (DISG)<sup>3</sup>, which are (and have been) open to all interested parties to attend. In addition, Ofgem has consulted upon a series of Regulatory Impact Assessments (RIAs) which considered key aspects of the regulatory, commercial and operational framework required to protect the interests of customers in the event that the proposed DN sales were to proceed.

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<sup>1</sup> Ofgem and the Gas and Electricity Markets Authority (the Authority) are used interchangeably in this document.

<sup>2</sup> A full list of documents published by Ofgem in respect of DN sales can be found at Ofgem's website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

<sup>3</sup> Ofgem's DISG meetings were held on a without prejudice basis and do not fetter the discretion of the Authority. The minutes of the meetings can be found at Ofgem's website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

The completion of these RIAs and associated conclusions documents, culminated in the publication of a Final Impact Assessment (Final IA) in November 2004.<sup>4</sup> As part of this Final IA, Ofgem undertook an examination of the potential costs and benefits associated with the proposed overall industry framework that would seek to protect the interests of customers in a divested industry structure and derived an estimate of the potential net benefits that could be achieved for customers if the transaction were to occur. Ofgem's base case estimate highlighted that net benefits to customers could potentially be in the order of £225million, in present value terms, if NGT were to sell four of its DN businesses.<sup>5</sup>

#### *Authority's decision on Transco's applications to dispose of four DNs*

On 11 January 2005, Transco submitted four applications to the Authority under ASC 29 of its original GT licence. The applications requested the Authority's consent to the proposed disposal of four of Transco's eight gas distribution networks (DNs) to four separate wholly-owned subsidiary companies, the shares in which would subsequently be sold to third party purchasers<sup>6</sup>. These applications for consent were considered at a duly convened meeting of the Authority on 20 January 2005. On 11 January 2005, Transco also submitted a request for the transfer of four of its GT licences relating to the four DNs which Transco is proposing to hive down to the four wholly owned subsidiaries.

At the 20 January 2005 meeting, the Authority provided its conditional consent to Transco under ASC 29 of Transco's original GT licence in the terms described in Transco's four applications for consent, and the consents (along with documentation setting out the background and reasoning behind the Authority's decision) (the "Consent Directions") were published on Ofgem's website on 1 February 2005.<sup>7</sup>

The conditional consent was granted at a time when the details of the regulatory, commercial and operational arrangements necessary to protect the interests of customers in a divested industry structure were still being consulted upon and developed. The Authority therefore attached a number of conditions to its consent to ensure that it would be satisfied that the arrangements developed and implemented over the following months would protect the interests of customers and would be consistent with the Authority's principal objective and statutory and other public law duties.

These conditions (set out in the Authority's Consent Directions<sup>8</sup>), included (without limitation):

- ◆ that the Authority must be satisfied with the proposed arrangements for industry codes (including without limitation the Uniform Network Code (UNC) and various network codes); and
- ◆ that the Authority has directed the Transco Network Code Modification Proposal to be implemented as it better facilitates the relevant code objectives (as defined in the original Transco licence).

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<sup>4</sup> *National Grid Transco – Potential Sale of gas distribution network businesses, Final Impact Assessment*, Ofgem, November 2004, 255/04a

<sup>5</sup> The net benefits were calculated in net present value terms over the period between 2005/6 and 2022/23.

<sup>6</sup> Transco also applied for consents under Paragraph 3 of Schedule 3 to the Gas Act 1986 (the Gas Act) to permit it to dispose of land (relating to the four relevant gas networks) that it has acquired compulsorily, to the four relevant wholly owned subsidiary companies. The Authority consented to these applications at its meeting on 20 January 2005.

<sup>7</sup> *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks Authority decision*, February 2005, 21/05.

<sup>8</sup> *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks Authority decision*, Ofgem, February 2005 21/05, Appendix 2.

The conditions to consent fall into two broad categories; conditions precedent,<sup>9</sup> which must be satisfied before the proposed hive-down can occur, and conditions subsequent,<sup>10</sup> which must be satisfied after hive-down occurs but before the proposed sale of the shares in the four relevant wholly owned subsidiary Transco companies to third party purchasers can occur. It should be noted that it is possible for the Authority to prepare new conditions subsequent to address issues which arise before share sale.

The Authority's Consent Directions specify that if any of the conditions precedent are not satisfied by 1 May 2005, or if the Authority is of the opinion that any such condition is unlikely to be satisfied by that date, then the Authority is entitled to extend the period for satisfying the conditions to an alternative date or waive or modify the conditions.<sup>11</sup>

On 13 April 2005, Ofgem requested that Transco provide an assessment of the extent to which each element of the conditions precedent have been satisfied and specifying how, in its view, this has been achieved.<sup>12</sup> Transco provided its assessment to Ofgem on 18 April 2005.<sup>13</sup>

Today, the Authority issued a letter under ASC 29 of Transco's original GT licence which sets out that the conditions precedent (set out in its Consent Directions) have been sufficiently satisfied to allow Transco to take steps towards the hive-down of Transco's four relevant DNs to the four relevant wholly owned subsidiary companies to occur on 1 May 2005 (or such later date as the Authority may direct).<sup>14</sup> However, in that letter, the Authority also indicated that it intends to issue a further letter to Transco requesting its confirmation that all of the conditions precedent have been fully satisfied. Once the Authority is satisfied that the conditions precedent have been satisfied in full, hive-down will be permitted to proceed and will take effect by a separate Implementation Direction. In this respect, and provided that the conditions precedent have been satisfied in full, the Authority would expect to issue a notice to this effect indicating that hive-down will proceed at 6am on 1 May 2005 later this week.

### *Restructuring of Transco's GT licences*

Ofgem's formal section 8AA and section 23 notices<sup>15</sup>, published in February 2005, proposed a large number of modifications to the structure and content of Transco's six GT licences. Of these, the proposed modifications most relevant to governance were to:

- ◆ provide for the establishment of a UNC by introducing Standard Special Condition A11 with the consequential switching off of ASC 9 following the introduction of A11;
- ◆ provide for the joint administration of the network code modification process by introducing Standard Special Condition A12; and

<sup>9</sup> The Authority's conditions precedent are set out in paragraph 21 of the Authority's Consent Directions.

<sup>10</sup> The Authority's conditions subsequent are set out in paragraph 23 of the Authority's Consent Directions.

<sup>11</sup> Authority's Consent Directions, paragraph 22.

<sup>12</sup> *Gas distribution network sales - Open letter to Transco requesting update on progress regarding conditions precedent of the Authority's consent directions*, Ofgem, 13 April 2005.

<sup>13</sup> *Update on progress regarding conditions precedent of the Authority's consent directions*, Transco, 18 April 2005.

<sup>14</sup> *Ofgem approves next stage of NGT's sale of four of its gas distribution networks*, 25 April 2005.

<sup>15</sup> *National Grid Transco – Potential sale of gas distribution network businesses, Formal consultation under section 23 and section 8AA of the Gas Act 1986*, Ofgem, February 2005, 45/05. This consultation relates to the restructuring of Transco's licence in order to protect the interests of customers under a divested industry structure. The s8AA consultation relates to the amendment and transfer of four of Transco licences to new wholly owned subsidiary companies, whilst the s23 consultation relates to the amendment of the remaining two Transco licences, which will continue to be held by Transco NTS and Transco RDN, consistent with the Authority's decision regarding legal separation.

- ◆ protect against the inefficient fragmentation of the services and systems that are required to implement the transportation arrangements by introducing Standard Special Condition A15.

Today, in line with its decision regarding Transco's satisfaction of the conditions precedent, the Authority:

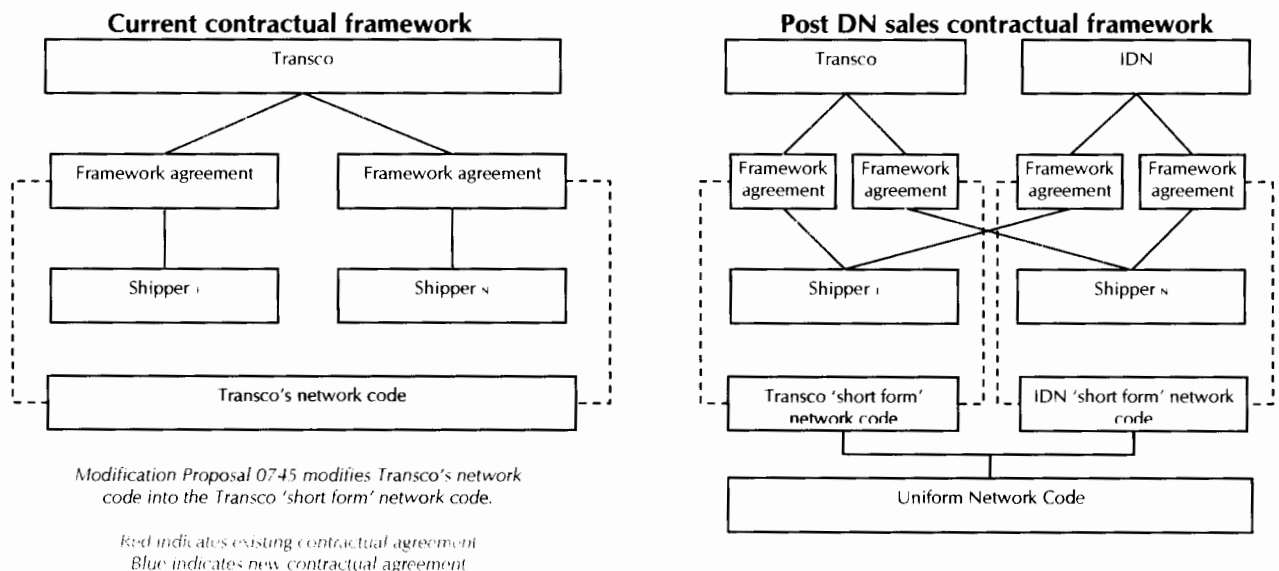
- ◆ directed that the relevant modifications to Transco's six GT licences under section 8AA<sup>16</sup> and section 23<sup>17</sup> of the Gas Act be made today; and
- ◆ consented to the transfer of four of Transco's GT licences to four new wholly Transco owned subsidiary companies.

It is noted that both the directions and consent to transfer are to take effect by way of a separate Implementation Direction from the 1 May 2005 (or such later date as the Authority may direct).

#### Proposed contractual framework

Under Transco's proposed post DN sales contractual framework, Transco and each independent DN (IDN) would have its own 'short form' network code (SFC) setting out the terms of its transportation arrangements, which would incorporate by reference the applicable terms of the UNC document (as established by the requirements of Standard Special Condition A11). In addition, Transco and each IDN would prepare jointly a UNC which sets out, to the extent that terms are common between relevant GTs, the transportation arrangements and modification rules. Figure 1 (below) depicts the proposed pre and post sales contractual framework.

**Figure 1 Pre and post DN sales contractual framework**



This approach will ensure the continuity of the existing contractual arrangements in relation to the NTS and those DNs which are to be retained by Transco (RDNs) and therefore protects the interests of customers. The Network Code as a contractual arrangement between shippers and Transco would be maintained throughout the transaction, and Transco's Network Code would continue to exist, albeit modified to a SFC incorporating, by reference, the UNC.

<sup>16</sup> Consent to transfer four of the GT licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986, Ofgem, 25 April 2005.

<sup>17</sup> Modification to two of the six GT licences held by Transco plc -direction pursuant to section 23 of the Gas Act 1986, Ofgem, 25 April 2005.

At the point that the restructured GT licences becomes effective, each SFC will contain minimal substantive provisions except to incorporate by reference the UNC. Initially, the UNC will contain all substantive provisions including the modification rules, however, it is possible that this could change over time (subject to consent of the Authority).

Between the date of this document and hive-down<sup>18</sup> (which is expected to be 1 May 2005), each of the four new wholly owned Transco subsidiary companies will seek to enter into four new framework agreements with each shipper. The new framework agreements will give effect to the SFC of each of the four new wholly Transco-owned DN companies.

It is noted that, on 21 April 2004, Transco submitted to the Authority a request that it designate the four individual SFCs in respect of its four wholly owned Transco subsidiary companies for the purposes of Standard Special Condition A11 of each company's respective licence. Transco proposed that such designation would take effect from the date of hive-down. This request was submitted for the purpose of standard condition 3 of the gas shippers' licence, and subject to Authority approval of Network Code Modification Proposal 0745.

#### *Development of the Uniform Network Code (UNC)*

Ofgem considered various aspects of the commercial and regulatory arrangements necessary to support a divested industry structure and protect the interests of customers through its impact assessments and DISG meetings. Following these considerations, during the period between September 2004 and late February 2005, Transco developed a UNC through a consultation process which involved:

- ◆ the establishment of a working group, attended by shippers, potential purchasers and other interested parties, that reviewed Transco's proposed business rules relating to the UNC;
- ◆ the publication of a consultation document<sup>19</sup> which invited views from interested parties regarding the business rules to apply to each section of the UNC; and
- ◆ a series of legal drafting workshops, attended by shippers, potential purchasers and other interested parties, which discussed the changes that Transco proposed to make to create the UNC based on the text of its existing Network Code.<sup>20</sup>

At the end of this process, Transco raised Urgent Modification Proposal 0745.<sup>21</sup> The Proposal sought to modify Transco's Network Code by removing virtually all of its operative text, creating a short form code that incorporates the UNC by reference. On 25 February, the Authority granted urgent status to the Proposal.

On 4 March 2005, Ofgem issued its consultation on the network code arrangements that would be put in place to support a divested industry structure and protect the interests of customers.<sup>22</sup> The purpose of the network code consultation was to give interested parties the opportunity to comment

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<sup>18</sup> At 'hive-down', Transco will transfer the assets of four of its DNs into four wholly owned subsidiary companies.

<sup>19</sup> *Towards a new industry framework: A consultation by Transco*, December 2004. This document was followed by an update note which summarised responses and set out Transco's views on the issues raised.

<sup>20</sup> The associated papers are available on Transco's website. See

<http://www.transco.co.uk/network%5Fsales/unccp.htm> and <http://www.transco.co.uk/network%5Fsales/erf.htm>.

<sup>21</sup> Transco Network Code Modification Proposal no. 0745 "Modification of the Network Code into Transco's individual ('Short Form') Network Code".

<sup>22</sup> "Gas Distribution Network Sales – Consultation on the Network Code Arrangements", Ofgem open letter, 4 March 2005 and "Gas Distribution Network Sales – Stage 2 of the Consultation on the Network Code Arrangements", Ofgem open letter, 29 March 2005.

on the UNC as drafted by Transco, as well as providing them with an opportunity to comment in the round on all aspects of the Authority's future decisions, including:

- ◆ Transco's Modification Proposal 0745<sup>23</sup>; and
- ◆ the proposed NTS and DN GT licence conditions which support the proposed commercial framework, specifically Standard Special Conditions A11, A12 and A15, as published in the February licence consultation.<sup>24</sup>

Ofgem's consultation on the network code arrangements was undertaken in two phases over a five week period. The first phase of consultation was undertaken over two weeks and completed on 18 March, following which Transco updated the UNC to reflect comments received from respondents. Subsequently, on 29 March, the second phase of the consultation commenced for a further two week period ending on 12 April. The purpose of this two stage consultation process was to ensure that respondents had an opportunity within an Ofgem consultation process to raise issues on the drafting of the UNC and to shape the documentation.

### **Urgent Modification Proposal 0745**

Urgent Modification Proposal 0745 seeks to modify Transco's existing Network Code by removing virtually all of the operative text, and introducing in its place text comprising Transco's SFC which incorporates the UNC by reference. Transco requested that this Modification Proposal follow urgent procedures, stating this was warranted given that the proposal was linked to an imminent date related event (namely the divestment of part of Transco's distribution business into subsidiary companies). Following careful consideration, Ofgem agreed to Transco's request to follow urgent procedures, as outlined in an Open Letter published on 25 February 2005<sup>25</sup>.

### **Respondents' views**

Transco received twelve representations in relation to Urgent Modification Proposal 0745.

Three respondents were supportive of the proposed modification and a further respondent offered qualified support<sup>26</sup> for the proposal to transform the existing Network Code into Transco's SFC. Of these respondents, three agreed that the implementation of Urgent Modification Proposal 0745 would better facilitate the relevant objectives outlined in ASC 9 as required by the Network Code modification procedures. These respondents also suggested that, in the event that the proposed changes to Transco's GT licences were effective, then Urgent Modification Proposal 0745 would further the relevant objectives set out in Standard Special Condition A11<sup>27</sup>.

In addition, two of these respondents considered that the proposal would establish common transportation arrangements and hence create a framework to support a divested industry structure. One respondent was also of the opinion that it would allow for appropriate governance of the relationship between users and individual gas transporters.

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<sup>23</sup> Transco submitted Urgent Modification Proposal 0745 to Ofgem on 23 February 2005. Ofgem granted urgent status on 25 February 2005. Urgent Modification Proposal 0745 was progressed in accordance with Transco's Network Code modification rules, parallel to the UNC consultation.

<sup>24</sup> "National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986", Ofgem, 45/05

<sup>25</sup> Request for Urgent Status for Modification Proposal 0745 "Modification of the Network Code into Transco's individual (Short Form) Network Code", Ofgem, 25 February 2005

<sup>26</sup> The respondent withheld full support because they did not agree with the granting of urgent status to the modification proposal.

<sup>27</sup> Although it should be noted that the relevant criteria to assess the proposal is ASC 9 of Transco's original GT licence.

However, of these respondents, two raised issues in relation to the urgent status of Modification Proposal 0745. They considered that although the reasons behind the Authority's decision to grant urgency were fair, it would have been possible for Transco to raise the modification earlier in the process and that this would have allowed a full consultation to take place. One respondent was of the opinion that, given the importance of this modification, there would have been benefits to the industry for it to have followed the full modification process.

Seven respondents stated that they did not support the proposed implementation of Urgent Modification Proposal 0745. Of these, four considered that the changes associated with this modification would not serve to better facilitate the code relevant objectives of the Network Code, as currently drafted. Two of these respondents acknowledged that while the implementation of the modification may better facilitate the objectives contained within proposed Standard Special Condition A11, the modification should not be approved on the basis of a licence condition that may, or may not, be implemented as part of DN sales. Two respondents stated that they were supportive of Urgent Modification Proposal 0745 in principle but highlighted that uncertainty regarding the contractual framework and associated UNC meant they could not support the implementation of this modification in its current form. A further respondent was of the opinion that such a significant modification to the industry framework would not be permitted under the current provisions of the GT licence and that, in order to achieve this a temporary relevant objective would need to be introduced within the licence.

Four of the respondents who were unsupportive of the proposal also raised issues with respect to the grant of urgent status to Modification Proposal 0745. Of these, three highlighted that the need for urgency had only become a factor due to the delay in raising the relevant modification and stated that Transco should simply have raised the modification earlier in the process. One respondent suggested that the justification for urgency was not substantive as this respondent was of the opinion that a delay would not forgo the benefits of DN sales. A further respondent stated that the Authority's decision to grant urgency to Modification Proposal 0745, in this regard, would set an unfortunate precedent in that it would allow Transco to submit proposals at a late stage to gain a tactical advantage.

Two respondents considered that the adoption of urgent status had not permitted sufficient consultation in relation to the proposed modification and that, as such, the modification should have been progressed through the established Network Code modification process.

A final respondent did not state a preference in favour of Urgent Modification Proposal 0745 or against it. However, the respondent stated that the Authority's decision regarding the proposal should be informed by reference to the existing licence conditions, not through anticipation of the implementation of future licence conditions or in relation to the commercial implications that it may have. The respondent also considered that the modification should have been raised earlier in the process and that it should not have received urgent status but should have been progressed through normal Network Code modification processes.

A number of respondents made reference to the alternative modification proposal that had previously been put forward by E.ON<sup>28</sup>. In this regard, two respondents set out that the implementation of changes to the Network Code undertaken through the processes proposed in Modification Proposal 0719 would have been more appropriate and that, in particular, this would have provided interested parties with sufficient time to respond to the consultation. One respondent was also of the opinion that the uncertainty associated with the UNC process could have been addressed through the

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<sup>28</sup> Modification Proposal 0719, "Changes to the Network Code to facilitate the sale of gas distribution networks."

implementation of Modification Proposal 0719 while a further respondent had concerns that Modification Proposal 0719 had not been given adequate consideration by the Authority.

One respondent stated that the reasons why it was necessary to transform the Network Code into a SFC remained unclear.

A further respondent also highlighted that although the objective of establishing a single set of arrangements through the SFCs was appropriate, the ability for transporters to amend these would remain and, as such, there may be some divergence between these codes.

### **Transco's view**

Transco expressed support for Urgent Modification Proposal 0745. Transco considered that the modification proposal would serve to better facilitate the code relevant objectives of ASC 9 of its original GT licence. In particular, Transco considered that the proposal would better facilitate the efficient and economic operation of its pipeline system under ASC 9(1). In this respect, it highlighted that the existence of comparators would allow Ofgem to compare the relative efficiency of the retained and independent DNs in setting future price controls and that it would therefore create incentives for these businesses to operate their pipeline networks more economically and efficiently. Transco also set out that the establishment of a common contractual framework would minimise costs associated with divergence in transportation arrangements.

In addition, Transco considered that a common contractual framework would ensure a level playing field for users in relation to the provision of transportation arrangements and that this would, in turn, facilitate effective competition between shippers and suppliers under ASC 9.

It further considered that implementation of this proposal would enable the creation of a multi-transporter environment while still as far as possible preserving the existing commercial framework and, as such, promote continuity with the current arrangements. It also highlighted that the implementation of Urgent Modification Proposal 0745 would be a key factor in permitting the sale to go ahead and thus enabling the delivery of associated benefits to customers.

In its response, Transco set out that the creation of its SFC was a fundamental building block in establishing a single set of transportation arrangements that would apply across the whole pipeline system. Transco set out that each SFC would incorporate by reference the common transportation arrangements set out in the UNC, thus binding relevant transporters and Users to a common set of contractual provisions for the provision of transportation arrangements. In addition, Transco outlined that to preserve contractual continuity, it would be necessary for the provisions contained within the existing network code to become part of the common contractual framework, and stated that this approach would be the most efficient way to do so.

Transco acknowledged that, over time, the arrangements may develop, creating divergence in the contractual framework but anticipated that the majority of modification proposals would be directed at the UNC and that, as such, all transporters would be required to adopt the relevant changes.

Finally, Transco noted that while it was aware that the modification would need to be assessed against the provisions of the existing ASC 9, it considered that it may also be appropriate to consider the consistency of the modification proposal in relation to new licence obligations. In this regard, Transco set out that Urgent Modification Proposal 0745 would also facilitate the achievement of the relevant objectives contained within Standard Special Condition A11.



## **The Authority's view**

The Authority has carefully considered all of the respondents' views and Transco's views on this Urgent Modification Proposal 0745. Having regard to the criteria set out in ASC 9, its principal objective and other statutory and public law duties, the Authority considers that this modification proposal better facilitates the achievement of the relevant objectives of Transco's Network Code, as set out in ASC 9 of Transco's original GT licence.

As part of its assessment, the Authority considered whether Urgent Modification Proposal 0745 was sufficient to meet the condition to consent as outlined in paragraph 21(d) of the Authority's Consent Directions. The Authority has also carefully considered the views of respondents to both Ofgem's UNC consultation, and the February licence consultation as well as respondents' views to the consultation on Urgent Modification Proposal 0745<sup>29</sup>. It should be noted, for the reasons set out in the letter "*Ofgem approves next stage of NGT's sale of four of its gas distribution networks*", the Authority has reached the view that this condition to consent has been met sufficiently to enable hive down to occur on 1 May 2005 (or such later date as the Authority may direct).

The following section, sets out why the Authority considers Urgent Modification Proposal 0745 better facilitates the code relevant objectives as described in ASC 9.

*Relevant objective as set out in ASC 9 paragraph 1(a) of Transco's original GT licence – the efficient and economic operation by the licensee of its pipeline system*

The Authority considers that the existence of comparators will allow Ofgem to compare the relative efficiency of the retained and independent DNs in setting future price controls and that this will create incentives for these businesses to operate their pipeline networks more efficiently and economically. The expected net benefits to customers of comparative regulation in this context were assessed in Ofgem's Final IA to have a base case estimate of £225m<sup>30</sup>.

Whilst considering the potential costs and benefits of the potential sale of gas DNs, the Authority considered that it was necessary to ensure continuity of the existing arrangements continued within the network code. Urgent Modification Proposal 0745 allows for the continuity of the arrangements through preservation of the contractual relationship between shippers and Transco in relation to its NTS and retained distribution networks. Therefore, Urgent Modification Proposal 0745 supports the creation of a multi-gas transporter environment and hence the benefits to customers of comparative regulation, whilst mitigating the risks of fragmenting the industry code arrangements.

The Authority considers that in the absence of continuity of arrangements as described by the Network Code, the costs of allowing DN sales to proceed could outweigh the expected net benefits to customers. The Authority therefore considers that Urgent Modification Proposal 0745 better facilitates objective 1(a) of ASC9 of Transco's original GT licence.

*Relevant objective as set out in ASC 9 paragraph 1(c) of Transco's original GT licence – the securing of effective competition between relevant shippers and between relevant suppliers*

The Authority also considers that Urgent Modification Proposal 0745 better facilitates the securing of effective competition between relevant shippers and between relevant suppliers. Under Urgent Modification Proposal 0745, Transco's Network Code will be modified into a SFC, which will include by reference the provisions of the UNC. The UNC will describe the business rules that will outline

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<sup>29</sup> National Grid Transco - Potential Sale of Gas Distribution Network Businesses – Formal Consultation under section 23 and section 8AA of the Gas Act 1986, Ofgem, 45/05

<sup>30</sup> See Amended Standard Condition 9, paragraph 1(a) of Transco's GT licences.

the offtake arrangements that will apply in the interim period (i.e. until the enduring offtake arrangements are implemented). The Authority considers that these arrangements better facilitate the securing of effective competition, given that the interim offtake arrangements remove the current first-come first-served allocation of capacity and replace it with an allocation process that is not unduly discriminatory.

### **The Authority's wider statutory duties**

In assessing Urgent Modification Proposal 0745, the Authority has also had regard to both its principal objective and other statutory duties, as set out in the Gas Act as its wider public administrative law obligation. The Authority considers that this Modification Proposal is consistent with Authority's principal objective, namely to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas.

In addition, the Authority considers that this Modification Proposal will also better promote the efficiency and economy on the part of licence holders to carry on any activity and the efficient use of gas conveyed through pipes (section 4AA (5)(a) of the Gas Act).

### **Other issues raised by respondents**

In responding to the Urgent Modification Proposal 0745, respondents raised two additional issues. These are:

- ◆ the need for a 'Temporary' code relevant objective; and
- ◆ the appropriateness of grant of urgency.

#### *'Temporary' code relevant objective*

The Authority notes one respondent's view that the proposed changes to Transco's Network Code are not permitted under the current provisions of Transco's original GT licences and that, in order to achieve the proposed changes, a "temporary" relevant objective (such as that introduced during the implementation of BETTA in the electricity sector) would need to be introduced within the licence.

In summary, the electricity transmission licence of NGT was modified to introduce a new temporary code relevant objective for BETTA to modify the BSC objectives and a BSC modification to clarify the ability of the BSCCo to undertake work regarding the creation of GB arrangements including among other things identification of the changes that were required to transition from those arrangements to a GB-BSC. This licence modification together with P108 clarified the ability of BSCCo to act and addressed issues of cost recovery. There are no such issues in the context of Urgent Modification Proposal 0745 and as such this is not necessary.

As set out above, the Authority considers that Urgent Modification Proposal 0745 better facilitates the achievement of existing relevant objectives of Transco's Network Code, as set out in ASC 9 of Transco's original GT licence. As such, the Authority does not consider that a temporary code relevant objective is necessary in order to be able to direct the modification.

## *Grant of urgency*

The Authority notes the comments made by a number of respondents in relation to the urgent status of the proposal. As set out in its decision letter on urgency<sup>31</sup>, Ofgem considers the decision to grant urgent status to Modification Proposal 0745 accords with Ofgem's guidelines for granting urgent status to a modification proposal.<sup>32</sup> In addition, Ofgem does not accept that the grant of urgent status deprived market participants of sufficient consultation on the proposal. In this respect, Ofgem notes that the proposal was consulted upon over a five week period that coincided with Ofgem's UNC consultation.

## **The Authority's decision**

For the reasons outlined above, the Authority has decided to direct Transco to accept Urgent Modification Proposal 0745. Having carefully considered the merits of the modification proposal itself, the Authority considers that it better facilitates the achievement of the objectives as outlined under ASC 9 of Transco's original GT licence. In particular, having regard to the Authority's principal objective, statutory and public law duties and the Authority's broader decision on Transco's conditions to consent to DN sales, the Authority considers that this proposal better facilitates the efficient and economic operation of Transco's pipeline system by contributing to the establishment of a framework through which customers can secure the benefits of comparative regulation of DN businesses. The Authority also considers this decision to be consistent with the principal objective and statutory and public law duties of the Authority.

## *Related issues – code relevant objectives under SSC A11*

Any decision placed before the Authority under ASC 9 of Transco's original GT licence has to be assessed against the criteria set out therein having regard to the Authority's principal objective and statutory duties together with its wider duties, the licensee's duties and all relevant facts. In essence in respect of this modification proposal this means that it has to be assessed against the background of the licence and the network code as they exist today, not as they may be in the future.

There are however circumstances where it may be appropriate to have regard to imminent changes to a licence or regulatory regime in order to assess whether the changes meets the relevant criteria. The Authority has today directed that the Section 8AA and Section 23 licence modifications be made today, but will take effect on 1 May, or such other date as the Authority may direct by way of a separate Implementation Direction.

As such, as a matter of good regulatory practice, to note the existence of the section 8AA and related section 23 licence consultations and the proposed form of SSC A11. In this context, and without fettering the future discretion of the Authority, the Authority considers that had this proposal been raised in the context of SSC A11 it would be likely to better facilitate the relevant objectives contained in this proposed condition. In particular, Urgent Modification Proposal 0745 would better facilitate the objective set out in SSC A11 para 1(a) relating to the efficient and economic operation of the licensee's pipeline system, and the objective set out in SSC A11 para 1(b) relating to the efficient and economic operation of the combined pipeline system.

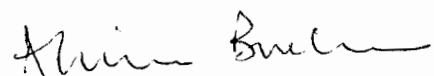
If you have any queries in relation to the issues raised in this letter, please feel free to contact me or alternatively, Mark Feather on 020 7901 7437 or Jessica Hunt on 020 7901 7431.

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<sup>31</sup> *Request for Urgent Status for Modification Proposal 0745 "Modification of the Network Code into Transco's individual (Short Form) Network Code"*, Ofgem, 25 February 2005.

<sup>32</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752\\_Urgency\\_Criteria.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752_Urgency_Criteria.pdf)

Yours sincerely,

A handwritten signature in black ink, appearing to read "Alistair Buchanan". The signature is fluid and cursive, with a long horizontal stroke at the end.

**ALISTAIR BUCHANAN**

**CHIEF EXECUTIVE**

Signed on behalf of the Authority and authorised for that purpose by the Authority