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value to customers*

ESP Connections Ltd, Shippers
and other parties

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19 May 2006

Dear Colleague,

Modification Proposal ESPC042: Introduction of a revised iGT AQ review process.

Having considered the issues arising from modification proposal ESPC042 and the views of respondents and having also had regard to its statutory duties, Ofgem believes that this modification will better facilitate the relevant objectives of the Network Code as defined in standard condition 9 of the Gas Transporters (GT) Licence. Ofgem has therefore decided to direct that it be implemented.

Background

In June 2003 Ofgem approved a modification proposal which introduced an industry agreed AQ Review procedure. This procedure was set out in an ancillary document which was referenced within the majority of the iGT network codes.

This procedural document was developed by iGTs and Shippers in the Gas Forum AQ sub-group. Subsequent changes and refinements to this document have also been agreed within this sub-group, rather than being subject to Network Code governance procedures.

The Modification Proposal

This modification proposal, which was granted urgent status by Ofgem on 22 March 2006, seeks to introduce a revised [iGT AQ Review Process](#) ancillary document, via a reference within the ESP Connections¹ (ESPC) Network Code. In contrast to previous AQ reviews these procedures will be enduring and so will negate the need to raise modification proposals prior to the start of each AQ review in coming years. In addition, these procedures will become subject to Network Code governance, with any future modifications being dealt with under the Network Code modification procedures, rather than by discussion and agreement within the AQ sub-group.

¹ ESP Connections, which was formerly known as British Gas Connections Ltd, is now owned by [ES Pipelines](#).

Respondents' Views

The consultation on this proposal received responses from four shippers, all of whom were supportive of its implementation. A common theme was that the modification would facilitate a more robust, consistent and transparent AQ Review process.

ESPC's View

ESPC states that it has been engaged in the AQ sub-group, fully intends to implement the procedures set out in the proposal and recommends its implementation. ESPC considers that correct AQs underpin the allocation and reconciliation processes in the national settlements systems. It goes on to state that because there can be no perfect way of developing AQs from often just two meter readings it is important that the methodology applied in turning such readings into an AQ are robust and consistent across the country to avoid the introduction of bias towards certain classes and certain shippers.

However, ESPC has raised concern at the AQ review process being amended on an enduring basis via an urgent modification proposal, and feels that a fresh, non-urgent proposal would be a more appropriate route.

ESPC considers that governing the AQ review process through the modification procedures will cause problems for future revisions, as each iGT currently operates different procedures. Although it is acknowledged that there is now a greater degree of co-ordination across the various networks, ESPC feels this cannot be guaranteed and may lead to confusion if the procedures do not remain aligned. ESPC therefore feels that the existing arrangements are more robust than those being suggested in this modification proposal.

ESPC also feels that it is inappropriate to amend governance arrangements at this time, given the current discussion around the potential for a Uniform Network Code (UNC) to be introduced to the iGT sector. ESP Connections feels that the appropriate place for the AQ review would be in the body of such a UNC rather than in an ancillary document to the existing Code(s).

Ofgem's View

Ofgem supports the implementation of this modification proposal as a means of updating and improving the iGT AQ Review Process. This proposal will allow the existing process to be adopted as an enduring arrangement which will negate the need to raise successive modification proposals for each AQ Review as has been the case in past years. This in itself should reduce the administrative burden upon both ESPC and shippers, leading to efficiency gains.

Ofgem understands ESPC's concern around the modification procedures and the difficulties of achieving a co-ordinated change control of the AQ review process. However, Ofgem considers that such co-ordination can be better achieved through formal modification procedures than the largely informal and ad hoc discussions of the AQ sub-group. Moreover, making the AQ Review Process subject to network code governance should improve the transparency of the existing arrangements and make them more consistent with the principles of good governance and better regulation.

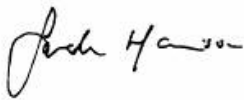
Ofgem notes ESPC's view that this is an inappropriate time to amend the governance procedures, given the discussions around a potential iGT UNC. Ofgem intends to issue a

consultation on such an iGT UNC shortly. However, Ofgem must assess each modification proposal on its own merits and determine whether it would better facilitate the relevant objectives than the existing provisions of the Network Code.

For the reasons set out above, Ofgem considers that the implementation of this proposal would better facilitate the relevant objectives of Network Code(s), in particular the efficient and economic operation by the licensee of its pipe-line system. Ofgem also agrees with the proposer that the improved accuracy of AQs that should result from these amended procedures will enable more accurate billing and therefore further facilitate competition between gas shippers and gas suppliers.

Should you have queries regarding this decision please contact Samantha McEwen on 020 7901 7032.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sarah Harrison', written in a cursive style.

Sarah Harrison
Managing Director, Corporate Affairs