

TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0745
**"Modification of the Network Code into Transco's individual ('Short Form')
Network Code"**
Version 1.0

Date: 23/02/2005
Proposed Implementation Date: 01/05/2005
Urgency: Urgent

Justification

Justification for Urgency

To indicate the considerations that are likely to be taken into account when determining if a Modification Proposal merits 'urgent' status, Ofgem published a paper, "Urgency Criteria", on 3 April 2003. The paper explains that given the varying nature of modification proposals and the wide-ranging justification for those proposals, it is not practicable to have a fixed definition of 'urgent'. Instead, each proposal must be treated on its own merits, but would only be treated as urgent if the modification could not appropriately be treated as non-urgent. However, the paper expresses the view that in general, urgent modifications are likely to exhibit one (or more) of the following characteristics:

1. There is a real likelihood of significant commercial impact upon Transco, Shippers or Customers if a proposed modification is not urgent; or
2. Safety and security of the network is likely to be impacted if a proposed modification is not urgent; or
3. The proposal is linked to an imminent date related event.

Transco's rationale for requesting urgent status is based on the fact that two of the above criteria are relevant to this Modification Proposal.

First, the purpose of this proposal is linked to an imminent date related event, that is the divestment of part of Transco's distribution transportation business into subsidiary companies, such event being undertaken as a precursor to the sale of the subsidiary companies. The divestment process is dependent upon a sequence of interrelated events, the timing of which is critical in ensuring the subsidiaries can be set up in accordance with the transaction timetable.

Secondly, failure to complete these steps in sequence, and to time, could ultimately jeopardise the transaction with significant commercial consequences for Transco plc and the prospective buyers. This would have a consequential detrimental impact on the benefits for customers that would otherwise result from the transaction as identified in Ofgem's Final Impact Assessment¹.

Overall, treating the NWC Modification Proposal as urgent would enable the timing of the consultation to be managed to a predefined timetable within this interrelated sequence of events.

¹ National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

In accordance with the future arrangements, a draft Uniform Network Code ("UNC") has been developed with the benefit of extensive industry consultation, and is expected to be consulted on by Ofgem during March 2005. It will assist all parties if this modification proposal, the provisions of the draft UNC and the Section 23 (required to establish distinct licences for Transco's Transmission and Distribution activities) and Section 8AA licence consultations (required to transfer of licences to the newly-formed Transco subsidiaries) can be considered together during an aligned consultation period. This would afford all interested parties a complete picture on the new regulatory and commercial framework that would operate as a result of the divestment.

Such a timetable would allow:

- a) the fullest opportunity for interested parties to make representations on this proposal in conjunction with the content of the UNC evolving through Ofgem's proposed consultation on the draft UNC, and;
- b) interested parties to consider, in parallel, the changes to the transporters' licence necessary to support the new industry framework, and in particular the conditions relating to the provision of a Network Code and the Uniform Network Code (Standard Special Condition A11);
- c) the Authority to consider representations made in respect of this proposal, the consultation on the draft UNC and the proposed licence amendments in the round when making a decision on whether or not to implement this proposal.

Urgent procedures offer a route for ensuring that the consultation on this Modification Proposal to create the Short Form Network Code can run in parallel with Ofgem's proposed consultation on the draft UNC. To do otherwise could break the inter-dependent sequence of consultations necessary to meet the divestment timetable, thus jeopardising the transaction.

On the basis of the above, Transco believes it is justified in requesting Urgent status for this proposal.

Justification of the Proposal

The contractual framework proposed by Transco to facilitate the sale of parts of its System, comprises the following features;

a) Present Arrangements

- Each shipper signs a Framework Agreement with Transco to establish a contract that allows gas transportation services, in accordance with the Network Code, to be acquired.
- The terms and conditions for the use of the System are established in Transco's Network Code.

b) Future Arrangements

- Each Shipper would be required to sign a Network Code Framework Agreement with each new Transporter on whose network it wanted transportation arrangements. Transco would be excluded from this requirement as the existing Transco / shipper framework agreement would be retained in un-amended form.

- In accordance with its Licence (i.e. the proposed Standard Special Condition A11 of the licences currently subject to consultation), each transporter would be required to have in place a Network Code setting out the terms by which shippers can make arrangements for the conveyance of gas across its transportation network. It is proposed that each *new* company's Network Code would be a relatively simple legal document, containing similar provisions to those that would result from the implementation of this modification proposal to Transco's Network Code. Accordingly, both the new and the modified individual Network Codes, (the "Short Form Network Codes"), would at their inception contain no substantive provisions relating to the transportation service and would exist solely to create transportation arrangements in respect of the network between the transporter and the user and to incorporate, by reference, the transportation rules contained within the UNC.
- Post implementation, the UNC would contain all the substantive transportation rules and is being developed to define the rights and obligations of transporters ("relevant transporters") operating the pipeline networks that are currently defined collectively in the Network Code as the System. The UNC would contain the business rules extracted from the Network Code and adapted to function in a multi-transporter environment, with new rules to be added as appropriate, for example to allow relevant transporters to acquire specific transportation services from other relevant transporters.

The creation of Transco's Short Form Network Code provides a fundamental building block in establishing a single set of transportation arrangements that would apply across the whole pipeline system. At present, the System is owned and operated by Transco, but on the proposed implementation date, the System would be disaggregated into separate systems (under the UNC, a separate system would be defined as an LDZ or the NTS), a number of which (seven LDZs) would be transferred into the ownership of four Transco subsidiary companies. Subsequent to implementation, it is Transco's intention to sell the subsidiary companies and their ongoing pipeline system operations.

Transco believes that the most efficient contractual framework for the new divested industry is that described earlier in this proposal as it requires all relevant transporters to offer transportation services on identical terms, at least initially. Over time, the proposed contracting framework would allow contractual arrangements to develop and facilitate a degree of divergence, should the Licensee's relevant objectives be furthered by such divergence. However, it is assumed that, in the majority of cases, change proposals, and their implementation, would be directed at the UNC, ensuring that all relevant transporters would be required to adopt the improvements delivered by change.

The changes required to create a UNC have been discussed extensively with the industry through the UNC Development and the Exit Regime Forums, and subsequent legal drafting sessions. It is anticipated that the draft UNC resulting from this development process will now be subject to consultation by Ofgem during March 2005, which will ultimately allow for the form and content of the UNC to be finalised.

The proposal will also allow Transco to be compliant with licence conditions, relating to the establishment of a Uniform Network Code, that are the subject of the current licence modification proposals.

Transco considers that the finalised form and content of UNC will be complete at the time when Ofgem consider whether to direct the proposed modification, having been the subject of significant industry development and consultation over the past six months. The UNC business rules have been developed through the UNC Development Forum and the Exit Reform Forum,

and have been consulted upon in December through Transco's "Towards an new industry framework" consultation, with the resulting legal text developed through legal drafting sessions. Furthermore, policies underpinning the changes have been consulted upon through Ofgem's Regulatory Impact Assessments, and through the Development and Implementation Steering Group (DISG). In addition, the draft UNC will have been subject to Ofgem's proposed consultation during March 2005.

It is recognised that further development to the draft UNC may be required during the consultation of this modification proposal to address any outstanding issues raised by the industry, together with issues that arise through the Ofgem consultation on the draft UNC. Indeed, Transco are planning to host a closing meeting of the UNC Development Forum on Thursday 24th February 2005 to address any outstanding concerns the industry may have. This modification proposal therefore acknowledges that the UNC document to which Transco's Short Form Network Code will ultimately refer will be that which is finalised following the Ofgem consultation process, and that the form and content of the UNC will continue to evolve through March 2005 as any outstanding concerns raised by the industry are addressed.

It is further recognised that in order to consider the proposal fully, industry participants will require access to the ancillary documents that will support the proposed industry structure, namely the JGA Agreement, the Agency Service Agreement (ASA) and the Offtake arrangements, such they the can review the interactions between these documents and the UNC. Accordingly, Transco propose to share these documents with the industry around the time when the consultation is launched.

This proposal is justified on the basis that its implementation is a fundamental step in establishing the arrangements necessary to facilitate network sales, which in turn would facilitate the relevant objectives placed on Transco (and as a consequence of hive-down would be placed on all licensees), to operate its / their pipeline system economically and efficiently. This would be achieved by ensuring that gas transportation services would be common across all systems operated by the licensees, would be governed by the same terms and conditions and would delivered to shippers using a common suite of IT systems, thus facilitating competition between shippers and between suppliers.

Nature of Proposal

The proposal is that, in order to create Transco's Short Form Network Code, all the substantive content of the Transco's Network Code is replaced with the text of the Short Form Network Code, to incorporate, by reference, the provisions of the UNC, the form and content of which will be finalised following Ofgem's consultation on the draft UNC. A current draft of the text of the proposed Short Form Network Code is attached to this proposal.

Purpose of Proposal

The purpose of the proposal is to allow for the creation of a multi-transporter commercial framework to support a divested industry structure, and therefore to deliver the customer benefits resulting from network sales identified in Ofgem's Final Impact assessment. The introduction of the finalised form of the UNC following Ofgem's proposed consultation, consistent with the implementation of this proposal, would ensure that transportation arrangements are common across all parts of the System, including those parts of the system operated by relevant transporters other than Transco. Adoption of this model would also ensure that relevant transporters would be required to operate to a common set of transportation services, governed by the same terms and conditions and implemented using a common suite of IT systems,

ensuring that competition between shippers and between suppliers is not adversely affected by divestment.

Transco consider that this would be consistent with the relevant objective 1 (c) as set out in Amended Standard Condition 9 (ASC9) of Transco's GT licence, together with relevant objectives 1 (d) (ii) and (ii) as set out in the proposed Standard Special Licence Condition A11 (SSLC A11) for each relevant Transporter in relation to the securing of effective competition between relevant shippers and relevant suppliers.

Implementation will allow the potential benefits to customers resulting from network sales, as identified in Ofgem's Final Impact Assessment on Network Sales², to be realised, obtained by the introduction of comparative competition and the consequential commercial drivers on relevant transporters to operate their pipeline networks economically and efficiently. Transco believe that this will further the relevant objective under 1 (a) of ASC9 and SSLC A11 - the efficient and economic operation of each transporter's pipeline system - and further the relevant objective 1 (d) (iii) under the proposed SSLC A11 for each relevant transporter in the securing of effective competition between DN operators.

Taken together, Transco considers that the adoption of a common model, and the prospect of customer benefits through comparative regulation will serve to further the relevant objective 1(b) as set out in the proposed SSLC A11 for each relevant Transporter by promoting "...the co-ordinated, efficient and economical operation of (i) the combined pipeline and/or (ii) the pipeline systems of other relevant transporters".

Transco also consider that the proposed modification rules associated with the UNC, administered by the Joint Office, will further the relevant objective 1 (f) under the proposed SSLC A11 for each relevant transporter – "...the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code".

Consequence of not making this change

The absence of the short-form Network Code/UNC concept would require each relevant transporter to develop a Network Code containing all relevant provisions relating to gas transportation across its system. This would not be consistent with the objective of providing a common set of arrangements across the divested gas distribution network, potentially creating fragmentation in such arrangements, damaging competition with a consequential negative impact on consumers, resulting in costs for industry participants, and undermining many of the benefits of network sales.

Should this proposal to create Transco's short form code not be implemented, then for the transaction to progress, a new contracting framework would have to be developed. This is likely to jeopardise the transaction, putting at risk the realisation of the benefits to customers identified in Ofgem's Final Impact Assessment.

Area of Network Code Concerned

All Sections of the Network Code, including the Transition Document.

² National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

Proposer's Representative

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Proposer

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Signature

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