

The Joint Office, Transporters,
Shippers and other interested parties

Your Ref:
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10 June 2005

Dear Colleague,

Uniform Network Code modification proposal 008: 'Specific Amendments to the Modification Rules' (formerly Transco Network Code modification proposal 731).

Ofgem¹ has carefully considered the issues arising from this proposal and has decided not to direct the implementation of the modification, as we do not believe that it will better facilitate the achievement of the relevant objectives of the Uniform Network Code (UNC), as set out in standard special condition A11 of relevant Gas Transporters Licences. In this letter we explain the background to the modification proposal and outline the reasons for making our decision.

Background to the proposal

Gas Transporters (GTs) are obligated under the conditions of their licence to establish transportation arrangements consistent with their duties under section 9 of the Gas Act 1986. The document specifying such transportation arrangements is referred to as the network code. The GT licence also obliges GTs to prepare a document outlining the modification procedures for the network code.

Until recently the modification rules for Transco's network code were a separate document and therefore not subject to the governance arrangements they provided. The implementation of modification 679 brought about the inclusion of the modification rules in network code (section Y). As such, any signatory to the network code can propose an amendment to the modification rules.

Since the implementation of modification 679, a number of modification proposals have been raised in relation to modification rules, seeking to improve governance arrangements for network code changes. These proposals are largely the result of work undertaken by the Gas Forum working group.

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter

Transition from Transco's Network Code to the UNC

This modification proposal was originally raised in respect of Transco's network code, and followed the modification rules pertaining to that code. Following the implementation of modification proposal 745², and in accordance with the Part IV, paragraph 2.1 of the UNC transitional rules, this modification proposal is deemed to be made in respect of the UNC.

As part of the introduction of the UNC, the modification rules were amended to include, amongst other things, a newly constituted modification panel which is empowered to assess the content of final modification reports and to make recommendations on proposals. Voting arrangements were also changed such that all determinations will be on the basis of panel majority.

The commencement of the UNC also saw the introduction of the Joint Office, which acts in a neutral manner, administering the UNC modification procedures on behalf of relevant GTs. As such, the Joint Office provides chairmanship of meetings, including the modification panel, workstreams, development workgroups and review groups, in accordance with the Chairman's Guidelines.

In addition to the above, changes to the workings of the modification procedures themselves with a direct bearing on this proposal include the ability of all parties to propose alternative modifications, rather than simply the code owner, as was previously the case. Provision was also made for modification proposal reports to be produced by independent Subject Matter Experts (SME), who may be nominated by all parties.

At its meeting of 3 May 2005, the UNC Modification Panel agreed to the re-numbering of live modifications carried over into the UNC under the transitional rules, with modification proposal 731 being re-numbered as UNC modification proposal 008. The Panel also voted for this modification proposal to proceed without re-consultation.

Ofgem has therefore considered this modification proposal against the relevant objectives of the UNC, as set out in standard special condition A11 of relevant GT licences.

The proposal

This proposal sought to address several areas of the modification rules which had been identified as causes of concern to shippers by the Governance Workstream. These issues were centred on the following three areas:

1. Modification Panel - *giving the panel, rather than Transco alone, more decision making in the operation of the governance regime, by:*
 - a. the introduction of a User Vice Chairman;
 - b. clearer arrangements for overseeing and directing the work carried out by Workstreams; and
 - c. changing voting so that all determinations are by panel majority with the provision of clear default positions where a determination is not made.

² See www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11299_745_letter.pdf

2. Modification Proposals and Reports - *giving greater equality to users and sharing more information earlier in the process, by:*
 - a. Defined points at which the proposer may change a modification proposal;
 - b. The removal of confusing Alternative Proposals provision, and;
 - c. The need for additional information about systems impacts and implementation timescales during consultation.

3. Development – *Making the process more transparent and participative, by:*
 - a. Giving wider ability for appeals to the panel;
 - b. Tighter terms of reference and clearer defaults, and;
 - c. Making it easier for a proposal to be sent to consultation.

The proposer provided a copy of the modification rules containing marked up revised text, which they considered would address the three areas of concern identified, and give effect to all of the proposals outlined above. The revised text also included a number of other amendments, such as new defined terms, while other were deleted, changes to cross-references etc. The intent was therefore to modify section Y in its entirety. This document was also drafted on the assumption that certain other governance related modification proposals which had previously been raised would be accepted by Ofgem and successfully implemented. The proposer therefore acknowledged that the drafting was not definitive and would be subject to the approval of those other modification proposals.

The proposer considered that implementation of this proposal would better facilitate relevant objective b), the efficient discharge of its obligations under this licence, by allowing Transco to better discharge its licence condition 4D "Conduct of Transportation Business" by making the Rules more neutral and removing present examples of discrimination which favour Transco and Transco's proposals above those of Users.

Respondents' views

Transco received six representations in response to its consultation on this modification proposal, all of which supported implementation.

General comments included that this proposal would make the network code governance regime more equitable, ensuring greater openness and accountability. It was suggested that the changes would result in better informed debate, improve the quality of proposals and may result in savings in industry effort expended in the modification process. It was also commented that the proposal should ensure that Ofgem has better quality information available on which to make its decisions.

In addition, respondents offered detailed comments on the following:

Modification Panel

In regard to the introduction of a vice chairman role to the modification panel, respondents' comments included that this would provide confidence that a safeguard is in place to ensure that panel meetings may continue should the chairman be absent and would thereby allow for more efficient use of time. It was also stated that there would be no serious risk of this hindering the

business of the panel, or preventing Transco from discharging its licence obligation to 'operate' the modification process.

Respondents also welcomed changes in voting in the context of panel decisions, indicating that this would address an inappropriate imbalance by preventing a single user skewing the process, thereby preventing inappropriate delay of consultation on proposals.

Workstream Guidelines

There was a general level of support from respondents for workstream chairmen attending modification panel meetings. Aside from recognising the need to remove the requirement where workstreams have not met between panel meetings, one respondent stated that having a representative present would provide the panel with more clarity and transparency. A further respondent suggested that panel approval for non-attendance could be sought in reasonable time prior to meetings.

Modification Proposals and Reports

Comments on the variation of modification proposals included that the proposal would enable both Transco and users to modify their proposals as they consider appropriate and would introduce more flexibility and equality in code, removing an unnecessary and confusing asymmetry in the current arrangements. It was also stated that this would be an efficient use of all participants' time, and that this would not require an extension to timescales for modification proposals on a universal basis.

In addition, one respondent highlighted the need for early additional information from Transco, during the draft modification report stage, about the likely systems impacts and implementation timescales. This would assist shippers in making informed decisions on various proposals.

Transco's view

Although it supported elements of the proposal, considering that some could be implemented outside of the network code modification process, Transco opposed implementation for the following reasons:

Modification Panel

In respect of the proposed vice chairman role to the modification panel, Transco indicated its belief that existing network code arrangements had proved satisfactory. It went on to state that appropriate and effective chairmanship of the modification panel was entirely consistent with its licence obligations in respect of the network code and that this should provide assurance that the business of the panel will continue to be conducted in a satisfactory manner. Transco did not believe that the appointment of a vice chairman would lead to any greater assurance in respect of the conduct of business.

Workstream Guidelines

Transco did not believe that the proposed attendance by all workstream chairmen at modification panel meetings would be necessary, nor consistent with efficient and economic operation of the pipe-line system.

Ofgem's view

Rather than each of the issues of concern identified being taken forward as individual modifications, this modification proposal sought to modify section Y in its entirety, with each revision contributing to the desired improvements.

Ofgem welcomes measures which improve the modification process and is therefore sympathetic with the intent of this proposal. However, Ofgem considers that this modification proposal has been overtaken by events and largely superseded. As noted above, a number of changes were made to modification rules in the transition from the network code to the UNC, some of which address the particular rules that had previously been raised as areas of concern in this modification proposal. For instance;

- the UNC modification panel is now chaired by the Joint Office³;
- the role and constitution of the panel is different, being made up of an equal number of GT and User representatives, in particular addressing what was perceived as a Transco veto;
- modification reports are now produced by Subject Matter Experts, who are agreed by the panel;
- recommendations are now made by the panel, rather than simply Transco;
- all Users now have the ability to raise alternative modification proposals.

The modification proposal also assumed the acceptance and subsequent implementation of certain modification proposals which were in fact rejected⁴. The baseline against which the proposal was working was therefore inaccurate prior to the transition to the UNC.

Whilst some aspects of the modification proposal may still be have merit and be relevant to the new arrangements, Ofgem is not able to accept only parts of a proposal and reject others, but is required to decide upon the proposal in its entirety. Ofgem does not consider that the proposal in its current form will further any of the relevant objectives. In particular, Ofgem notes that basis on which the proposer considers that the proposal furthers the relevant objective of the efficient discharge of the licensee's obligations under licence no longer applies. The functions which the proposer considered had potential to be carried out by Transco in a discriminatory manner are now conducted by the Joint Office.

To the extent Users may have any remaining concerns with the UNC governance arrangements, Ofgem would expect these to be raised at, and taken forward by, the recently established review

³ The 'Joint Office' of Gas Transporters has been established to administer the modification procedures in a non-discriminatory manner, in accordance with standard special condition A12 of the GT licence.

⁴ Modification proposals 713: 'Ability for User's to Vary their Modification Proposals' and 714: 'Use of Principles of Governance in Applying Section Y of Network Code (renumbered as UNC Mod 002)'.

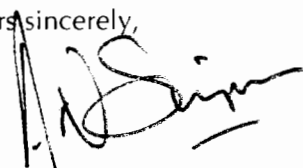
group under UNC Review Proposal 020 *'Proposal to establish a review group to assess whether any changes are needed to UNC Governance in the light of the imminent introduction of the Appeals mechanism against Authority UNC modification decisions'*. Whilst the Appeals mechanism has provided the trigger, Ofgem anticipates a holistic review of the modification rules. Ofgem would suggest that whilst any subsequent modification proposals may be complementary, they are not contingent upon each other and are drafted with regard to the relevant objectives as set out in standard special condition A11, in particular f); *'...the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code'*.

In addition to the concerns raised above, Ofgem considers that implementation of this proposal ahead of this review would actually be contrary to, rather than further facilitate, relevant objective f).

Ofgem's decision

For the reasons outlined above, Ofgem cannot direct that this modification proposal be implemented, as we do not consider that it would better facilitate the achievement of any of the relevant objectives of the UNC, as outlined under standard special condition A11, to do so.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Simpson', written over a vertical line that serves as a separator between the closing and the name.

Nick Simpson
Director, Modifications