

URGENT Modification Report
Modification of the Network Code into Transco's individual ('Short Form')
Network Code
Modification Reference Number 0745
Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

a. Transco's Justification for Urgency

Transco's justification that the proposal should be granted urgent status was based on the following rationale.

Firstly, the purpose Modification Proposal 0745 ("the 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 that 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 Assessment.¹

In accordance with the future arrangements, a draft Uniform Network Code ("UNC") has been developed with the benefit of extensive industry consultation, and was consulted on by Ofgem during March / April 2005 in parallel with the consultation on this proposal. It was considered that it would assist all parties if this modification proposal, the provisions of the draft UNC, and the formal Section 23 & Section 8AA licence consultation² (required for the modification of the licences of Transco's NTS and retained distribution networks and for the modification and transfer of licences to the newly-formed Transco subsidiary distribution networks, necessary to supported a divested industry structure) could 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.

¹ National Grid Transco – Potential Sale of Gas Distribution Network Businesses. Final Impact Assessment, Ofgem, November 2004

² National Grid Transco – Potential Sale of Gas Distribution Network Businesses. Formal Consultation under section 23 and section 8AA of the Gas Act 1986

Such a timetable would allow:

- i. the fullest opportunity for interested parties to make representations on this proposal in conjunction with the content of the UNC evolving through Ofgem's consultation on the draft UNC³, and;
- ii. interested parties to consider, in parallel, the changes to the transporters' licences necessary to support the new industry framework, and in particular the proposed Standard Special Condition A11, relating to the provision of a Network Code and the UNC;
- iii. 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.

Overall, treating the proposal as urgent would enable the timing of the consultation to be managed to a predefined timetable within this interrelated sequence of events. Urgent procedures would offer a route for ensuring that the consultation on this Modification Proposal to create the Transco's individual Short Form Network Code could run in parallel with Ofgem's consultation on the draft UNC. To do otherwise could have disrupted the inter-dependent sequence of consultations necessary to meet the divestment timetable, thus jeopardising the transaction.

b. Ofgem's Response

Following careful consideration of Transco's request that the proposal be treated as urgent, Ofgem decided to grant the proposal urgent status⁴. In reaching its decision, Ofgem took into account Transco's views regarding the imminent date related event (i.e. Network Sales) and the likelihood of significant commercial impact on Transco. Ofgem considered the justification for urgency accords with Ofgem's guidelines for granting urgency status to a modification proposal. In particular, Ofgem considered that if the modification proposal were to follow non-urgent procedures, there is a risk that the benefits to customers that would otherwise result from the transaction, identified in Ofgem's Final Impact Assessment and the Authority's February 2005 decision document, may be lost.⁵

³ Ofgem Open Letter Gas Distribution Network Sales –consultation on Network Code Arrangements, March 2003 and 99/05 – Ofgem Open Letter Gas Distribution Network Sales - Stage 2 of consultation on the Network Code Arrangements.

⁴ Urgency Decision, Ofgem, 28 February 2005

⁵ National Grid Transco – Potential Sale of Gas Distribution Network Businesses. Final Impact Assessment, Ofgem, November 2004, and National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks, Authority Decision February 2005 21/05

Urgency Timetable

Given the relationship between:

1. this modification proposal,
2. the section 8AA and section 23 licence modifications issued for consultation on 14 February 2005; and
3. Ofgem's consultation on the network code arrangements, including the Transco prepared draft UNC

Ofgem decided that the timetable for the proposal should align with the timetable adopted in relation to the Ofgem consultation on network code arrangements. Ofgem considered it appropriate that an aligned timetable is followed to ensure transparency of information and to ensure interested parties in respect of both the consultation on this proposal and Ofgem's proposed consultation on the UNC are fully informed of developments.

In relation to the UNC consultation, Ofgem decided to adopt the following consultation structure:

1. **Stage 1** – weeks 1 and 2 – draft UNC issued for consultation for two weeks. Responses to Ofgem and Transco;
2. **Week 3** – Transco to consider responses, revise and reissue the UNC and a log of changes; and
3. **Stage 2** – weeks 4 and 5 – the revised UNC is subject to consultation with responses to Ofgem only.

Stage 1 was launched on 4 March, with responses due by 18 March.

Stage 2 was launched on 29 March, with responses due on 12 April.

Procedures Followed

In respect of this modification proposal, the period for representations was opened on 4 March 2005, with an opportunity to provide responses at the end of the first stage of the UNC consultation on 18 March, and, consistent with responses due in respect of the second stage of the consultation on the UNC, closed out for representations on April 12. The complete timetable for the consultation is as follows:

Proposal sent to Ofgem for Urgent Status consideration	23/02/05
Proposal agreed as urgent	25/02/05
Circulate to Users requesting representation (aligned with Network code arrangements consultation for the draft UNC)	04/03/05
Opportunity to submit Stage 1 responses	18/03/05
Representation close-out	12/04/05
Modification Report issued to Ofgem	18/04/05
Ofgem decision expected by	25/04/05
Proposed Implementation Date	01/05/05

1. The Modification Proposal

This proposal would enable the creation of a multi-transporter commercial framework to support a divested industry structure, thus enabling Transco's proposed sale of four of its gas distribution networks to go ahead.

It is proposed that Transco's Network Code be modified into Transco's Short Form Network Code, whereby the entire substantive content of Transco's Network Code is substituted with the text of a Short Form Network Code, to incorporate by reference, the provisions of the UNC. The proposed text of Transco's Short Form Network Code is included within section 19 of this report.

The UNC would contain all the substantive transportation rules and has been 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 Transco Framework Agreement would continue to create a contractual relationship with Users via Transco's Short Form Network Code and would apply to the retained Transco business (that is the NTS and the retained distribution networks), thus ensuring the continuity of transportation arrangements on Transco's NTS and retained distribution networks. The Short Form Network Code would incorporate by reference the provisions of the UNC, resulting in a contractual framework that would ensure that all parties would be bound by the common contractual terms in the UNC.

Although subject to the Authority approval of this modification proposal, Transco has provided the proposed Short Form Network Codes for Transco and the four subsidiary distribution network businesses to accompany this report. All Short Form Network Codes would take effect on the implementation day (currently envisaged to be 1st May 2005) and would be identical in all but name, thus ensuring a common contractual framework across all relevant transporters. Four new framework agreements would be established between Users and each of Transco's subsidiary gas distribution businesses to bind both Users and the transporters to their respective new Short Form Network Codes.

2. Transco's Opinion

Transco, as proposer, supports implementation of the modification proposal, for the following reasons:

At present, the System is owned and operated by Transco, but on the proposed implementation date, the System would be disaggregated into separate systems, resulting in a Transco business that would comprise the NTS and the retained four distribution networks, together with four Transco subsidiary distribution companies (these representing the South of England, Scotland, Wales and the West, and North of England networks). Subsequent to implementation, it is Transco's intention to sell the subsidiary companies and their ongoing pipeline system operations.

Implementation of this proposal would allow for the creation of a multi-transporter commercial framework, which as far as possible would preserve the existing commercial framework between Transco and Users to promote continuity with the present arrangements.

The proposal, therefore, represents a key enabler to support the proposed sale of four of Transco's gas distribution networks, thus enabling the delivery of the benefits to customers as detailed in Ofgem's Final Impact Assessment⁶.

Accordingly, the introduction of a common set of transportation provisions, as set out in the UNC, 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.

The creation of Transco's Short Form Network Code (together with the adoption of identical Short Form Network Codes by the new independent Distribution Network Operators ("IDNOs")) provides a fundamental building block in establishing a single set of transportation arrangements that would apply across the whole pipeline system. Each Short Form Network Code, 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.

Transco believes that the Modification of the Network Code into Transco's Short Form Network Code is necessary to allow the Transco Network Code to be part of the common contractual framework for the new divested industry and is the most efficient means of delivering this. If implemented, this contractual framework would require 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 better facilitated by such divergence. However, it is assumed that, in the majority of

⁶ National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

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.

3. Extent to which the proposed modification would better facilitate the relevant objectives

Transco's Gas Transporter Licence

Transco believes that implementation of the modification proposal would better facilitate Transco's relevant objectives under Amended Standard Condition 9 ("ASC9"):

- **ASC9 1(a)**, '*the efficient and economic operation by the licensee of its pipe-line system*'. Implementation of this proposal would allow the net potential benefits to customers resulting from network sales (estimated to be in the order of £225m in present value terms), as identified in Ofgem's Final Impact Assessment on Network Sales⁷, to be realised. The creation of new independent distribution networks should provide Ofgem with information regarding the appropriate level of costs that an efficiently run regulated gas distribution business should incur. In turn, it is expected that this information will enable Ofgem to use comparative analysis to compare the relative efficiency of Transco's retained Distribution Networks ("RDNs") and the IDNOs in setting future price controls, thus creating greater commercial incentives on Transco and the new independent transporters to operate their pipeline networks more economically and efficiently. The creation of a common contractual framework permitted by the implementation of this proposal would also minimise the costs associated with divergence in transportation arrangements that could occur if a common contractual framework was not in place. The implementation of this proposal would thus better facilitate the efficient and economic operation of the licensee's pipeline system under a divested industry structure.
- **ASC9 1(c)**, '*... the securing of effective competition between relevant shippers and between relevant suppliers*'. Transco considers that implementation of this modification would be consistent with the relevant objective set out in 1(c) by providing for the creation of a common contractual framework that would ensure a level playing field for Users with respect to the receipt of gas transportation services. Implementation would allow for a common set of transportation arrangements between transporters, thus allowing for consistency in the provision of transportation services to shippers and suppliers, and the consequential facilitation of effective competition that this implies.

The proposed amendments to Transco's Gas Transporter Licences, if approved, would take effect on May 1 2005. Implementation of this modification, subject to approval, would therefore coincide with the coming into force of amended licence conditions, against which subsequent modifications to the UNC would be assessed - specifically, the relevant objectives as set out in the proposed Standard Special Condition A11. Whilst Transco is fully aware that the Authority will assess this modification against the provisions of its existing Licence, specifically ASC9, Transco considers it appropriate to

⁷ National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

note the extent to which this modification, if implemented, would be consistent with obligations on relevant transporters to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) ("SSC A11 1") of their respective GT licences.

Proposed Gas Transporter Licences of the NTS, the retained Distribution Networks and Independent Distribution Networks

Although not strictly a requirement of the current Transco licence, the following is an assessment and commentary of how implementation of this proposal would enable all relevant GT licensees (Transco NTS, Transco RDNs and each prospective IDNO) to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their respective GT licences:

- **SSC A11 1(a)**, *'the efficient and economic operation of the pipe-line system to which this licence relates'*. – by ensuring that costs of operation can be judged in a comparative environment by the introduction of new distribution network operators as cost comparators.
- **SSC A11 1(b)**, *"... the co-ordinated, efficient and economical operation of (i) the combined pipeline and/or (ii) the pipeline systems of other relevant transporters"*. – by the introduction of a common contractual framework setting out the basis on which transporters would provide transportation arrangements, which as far as possible, would preserve the existing commercial framework between Transco and Users to promote continuity with the present arrangements.
- **SSC A11 1(d)** *'... the securing of effective competition (i) between relevant shippers; (ii) relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers'* – by the introduction of a single service provider (the transporter Agency) undertaking many of the system and data related services currently carried out solely by Transco.

Taken together, Transco considers that the adoption of a model that provides for obligations to be discharged centrally by common service providers, and the prospect of customer benefits through comparative regulation, would serve to facilitate the achievement of each of the relevant objectives set out above.

Overall, Transco believes that the implementation of this proposal would enable relevant transporters to comply with the prospective SSC A11 regarding the provision of transportation arrangements that satisfy the relevant objectives that would be set out in their respective gas transporter licences.

4. The implications for Transco of implementing the Modification Proposal, including
a) implications for the operation of the System:

Transco has adopted a minimal change approach to the development of the UNC whereby the provisions of the UNC are based on Transco's Network Code with changes only contemplated to facilitate the operation of the System in a divested industry structure. The contractual framework proposed by Transco, of which the implementation of this modification forms a key component, permits the contractualisation of what are currently internal arrangements within Transco, concerning the physical operation of its transmission and distribution networks.

This formalisation of arrangements between transmission and distribution activities is necessary to provide for the creation of four independent distribution networks and the inception of a commercial interface between, inter alia, each distribution network and the National Transmission System ("NTS"). Accordingly, with particular regard to considerations of accountability and clarity, security of supply and the potential for gas transporters to accrue efficiency savings, the implementation of this modification proposal would permit the establishment of a contractual framework where a Distribution Network Operator ("DNO"), including Transco for its RDNs, would be responsible for system operation and planning on its own network. As such, DNOs would also have responsibility for determining the level of available capacity on their network and securing sufficient capability in respect of exit capacity and diurnal storage capability from Transco NTS, necessary to meet 1-in-20 obligations.

The NTS would retain contractual responsibility for the physical operation of the NTS, which would include investment planning, maintenance activities and the management of interruption, as it relates to NTS.

Consistent with the conclusions of Ofgem's Roles and Responsibilities RIA⁸, Transco would retain the residual gas-balancing role and the obligations associated with energy settlement for the Total System. Transco would continue to operate the NTS and the retained distribution networks, and would for a transitional period, operate the independent networks under contract on behalf of the new owners. Accordingly, operation of the system would be largely unchanged, other than to establish formal and common contractual arrangements between Transco NTS and DNOs, required to replicate current internal arrangements for operation and system planning, particularly as they relate to where the NTS interfaces with a DN.

⁸ National Grid Transco – Potential Sales of gas distribution network businesses, Allocation of Roles and Responsibilities between transmission and distribution networks – Decisions document, Ofgem, May 2004

b) development and capital cost and operating cost implications:

Transco has borne the transporter costs associated with the **development** of a contractual framework to support a divested industry structure, of which the implementation of this modification is a key component. Costs associated with the set-up of the subsidiary companies would be borne by Transco.

There are no specific **capital** costs for transporters associated with implementation. However, if the costs associated with the establishment of a divested industry structure are considered i.e. the establishment of the Agency, the Joint Office and the restructuring into of distribution networks into separate transporter entities, there are costs associated with the divestment. All such costs would be borne by Transco.

The ongoing **operating** costs associated with the implementation of this modification, and concomitant contractual framework, would be borne by the relevant transporters in accordance with their obligations and responsibilities.

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Transco would not seek to recover any of the costs it has borne associated with the implementation of this modification.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Implementation of this modification is consistent with the current price regulation framework. It accords with Ofgem's view on price regulation with respect to the potential sale of Transco's distribution networks, viz. that the price controls would not, as a result of network sales, be reopened prior to the next periodic review. However, the implementation of this proposal would allow for comparative regulation in the setting of future price controls, with the benefits ultimately accruing to customers in accordance with Ofgem's Final Impact Assessment⁹.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco believes that its risk profile would not be materially affected by the implementation of this proposal.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

There are two minor system modifications to the UK-Link system have been programmed as part of hive-down although both would be required if the short form code model was adopted or not.

They are:

a) Invoice formats

New invoice formats have been introduced to allow each transporter to submit invoices for transportation services as they pertain to its network. Supporting information would continue to be sent to shippers (in the existing invoice format), to allow “end-to-end” supply point transportation charges to be validated. This is a Class 2 system modification that would be implemented following hive-down once all the residual pre-hive-down transportation invoices have been submitted in the name of Transco plc.

b) Accession arrangements.

Functionality has been built into UK Link to allow shippers to accede to transportation arrangements, “DN-by-DN”. This functionality is dual role, as it would allow credit sanctions to be applied on a DN-by-DN basis. This is a Class 1 system change and has already been implemented.

The above changes are required to support a multi-transporter environment, and not a direct result of the implementation of this proposal and the creation of Transco’s Short Form Code.

Should implementation be approved, the proposed regulatory and commercial framework provides for the creation of an Agency to administer certain activities currently undertaken by Transco regarding changes to industry systems, the scope of which is consistent with Ofgem’s Regulatory Impact Assessment (“RIA”) on Agency and Governance Arrangements.⁹

Transco considers that the Agency is a key element of the proposed industry framework and its creation is necessary to protect the interests of Users, as it is expected, consistent with Ofgem’s views, to mitigate the potential for significant costs that could otherwise arise as a result of multiple interfaces being created following DN sales. As such the creation of the Agency is provided for in the proposed gas transporters licence (Standard Special Condition A15) and the provisions of the UNC – TPD, Section V6.5, which acknowledges that the obligations of transporters relating to the provision of certain services currently provided by Transco could be discharged by the Agency. Both the licence conditions relating to the agency and the relevant provisions of the UNC have been developed with the close involvement of the industry and have both been subject to consultation by Ofgem.

⁹ National Grid Transco – Potential sale of gas distribution businesses. Agency and governance arrangements - Decision document, Ofgem, May 2004

An Agency Services Agreement (“ASA”) would form the contractual arrangements between transporters and the Agency (“xoserve”) with respect to the provision of agency services. The ASA has also been subject to Ofgem’s consultation on Network Code arrangements.

In short, the creation of the Agency, by providing a common set of commercial systems and processes, would ensure that Users would continue to face a single interface in respect of the provision of a wide range of commercial services provided by Transporters.

Accordingly, implementation the proposal would result in minimal system changes with a limited impact for both Transco and Users.

7. The implications of implementing the Modification Proposal for Users

Transco has adopted a minimal change approach to the development of the proposed contractual framework whereby the provisions of the UNC are based on Transco’s Network Code with changes only contemplated to facilitate the operation of the System in a divested industry structure. The implementation of the proposal would permit the establishment of a contractual framework in which Transco’s Network Code and the network codes of the new DNs would incorporate, by reference, the common contractual provisions in the UNC, (which would contain substantively the same provisions of Transco’s Network Code), thus providing a common contractual framework and ensuring continuity with current arrangements. To the extent that Transco’s Network Code has been used as the basis for developing the UNC, these necessary changes have been discussed extensively with the industry through the UNC and Exit Regime Forums, and subsequent legal drafting sessions.

The implementation of this modification proposal represents a key enabling component in the establishment of a contractual framework to support a divested industry structure in which multiple transporters are created. The creation of multiple gas transporters would require Users to contract with gas transporters other than Transco for the provision of gas transportation services across the System. Therefore, in addition to the present arrangements whereby each User signs a Framework Agreement with Transco to establish a contract that allows gas transportation services, in accordance with the Network Code, to be acquired, each User 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.

The implementation of this Modification Proposal therefore has limited direct implications for Users. Indeed, from the outset Transco’s proposals for the development of a contractual framework to support a divested industry structure have recognised the imperative of mitigating any potential costs or disruption that could be caused to Users as a result of network sales, whilst also facilitating the delivery of benefits to customers.

The arrangements for the creation of an agency to administer certain activities currently undertaken by Transco does appear to depart from current arrangements; yet in practice the agency arrangements set out in Ofgem's RIA on Agency and governance arrangements¹⁰ provides for the near seamless provision of services to Users in a divested industry structure. The creation of 'the Agency' is, in effect, the hiving down of Transco's Shipper Services business unit into a separate legal entity.

However, under the proposed contractual framework, there are a number of activities that would not be the responsibility of the Agency. Depending of the extent of its supply point portfolio, a User may need to interface with a larger number of legal entities (although, operationally, the number of points of contact will remain largely unchanged for Day 1:

- **Connections**

Shippers would contact the relevant DNO or other competitive connection service providers directly.

- **Site works interfaces**

Site works would be the responsibility of the relevant network owners and therefore site works involving shippers would require interfaces to be established with each network owner involved. However, as site works are dealt with on a case-by-case basis, Transco does not anticipate a significant increase in shipper workloads.

- **Transporter Agency Activities:**

The majority of the Network Code transporter obligations that relate to the transfer and the processing of data will continue to be undertaken by part of Transco known as shipper services, which will itself be hived down into a company jointly owned by transporters – the Agency. Note, that while Transportation invoicing would continue to be produced and transmitted using current systems and transfer media, the Credit management role would become the responsibility of each transporter and, as such, the number of credit counterparties for each shipper would increase, although the total amount of credit required to be provided by a shipper would peak during the transition it is expected that this would, in aggregate, re-establish at current levels.

¹⁰ National Grid Transco – Potential sale of gas distribution businesses. Agency and governance arrangements., Decision Document, Ofgem, May 2004.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

- **Terminal Operators**

Transco is not aware of any implications for Terminal Operators resulting from the implementation of this Modification Proposal.

- **Consumers**

Ofgem's Final Impact Assessment¹¹ estimated that the base case for net potential benefits to customers resulting from the sale of four of Transco's DNs, and the introduction of comparative regulation, to be in the order of £225million in present value terms.

- **Connected System Operators ("CSOs")**

Transco is not aware of any substantive implications for CSOs resulting from the implementation of this modification proposal. However, the implementation of this modification would, in some instances, require the novation of CSEP NExA arrangements, and the modification of safety cases. Current contracts for the provision of emergency services to independent Gas Transporter ("iGT") networks would novate to the IDNOs in respect of the networks being sold. These changes do not imply any substantive change to CSO activities.

- **Suppliers**

With respect to connections and metering, suppliers would need to contract directly with the relevant transporter for the provision of a 'last resort' meter provision, although in most cases suppliers would continue to interface with their current meter service providers. Initially, Transco would provide a "meter of last resort" service on behalf of the IDNOs on a transitional basis, such that supplier interfaces continue to operate as now, until such time as the IDNOs are able to provide their own service.

- **Producers**

Transco is not aware of any implications for Producers resulting from the implementation of this Modification Proposal

- **Non-Network Code Party**

Transco is not aware of any implications for other Non-Network Code Parties resulting from the implementation of this modification proposal.

¹¹ National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

9 Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

This modification proposal represents one part of a process that culminates on May 1 2005 ("the appointed day"). Key to this process is the prospective licence condition SSC A11, proposed as part of Ofgem's licence consultations, which would require each Licensee to have in place a network code on the appointed day.

On the appointed day, subject to the necessary consents being in place, Transco intends to hive down four of its distribution networks into the ownership of four Transco subsidiary companies. The consultation to which this modification proposal has been subject has been conducted in parallel with Ofgem's consultations on the provisions of the draft UNC and the Section 23 and Section 8AA amendments to Transco's existing six licences. This alignment of consultation periods has afforded interested parties a complete picture of the regulatory and commercial framework that would operate in a divested industry structure.

The subsequent sequence of regulatory and legislative events pertinent to the implementation of this Modification Proposal, (subject to Authority approval), is as follows:

- **April 25:**
 - Direction of Section 8AA and the second Section 23 licence amendments to take effect on the appointed day.
 - Ofgem directs implementation of this proposal to take effect on the appointed day.
 - Short Form Network Codes established for each IDNO to take effect on the appointed day.
- **April 25 – 29:**
 - Transporters and Users sign Framework Agreements to enable accession to Short Form Network Codes on the four new independent distribution networks on which they ship, or intend to ship, gas.
- **May 1 (the appointed day):**
 - Section 8AA modification and transfer of amended licences to independent distribution networks.
 - Section 23 amendment to Transco NTS and RDN licences.
 - Modification proposal 0745 is implemented.
 - All Short Form Network Codes and UNC take effect.
 - Gas Act (Exemption) (Number 2) Order 2005 become effective.
 - Framework Agreements Execution date for Framework Agreements: consequently transportation arrangements operate under the UNC and Short Form Network Codes.

But for the sequence of events described above, implementation of this modification proposal would put Transco in breach of its obligations and would not allow for the contractual framework to support the creation and subsequent divestment of the four distribution networks.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages:

- **Savings for Customers**

Ofgem estimates the base case of the net potential benefits for customers that would materialise as a result by the introduction of additional network operators into distribution activities would be £225 million. In Ofgem's Final Impact Assessment¹², costs were identified as being likely to be incurred by customers as a result of a divested industry structure, of which the implementation of this modification proposal would facilitate. Ofgem has consulted extensively with shippers and suppliers in order to understand the level of costs that are likely to arise as a result of changes to systems and protocols that would be necessary were the proposed sale of DNs to proceed. Ofgem has analysed the data received from shippers and has estimated that the base case level of potential costs to be £100 million and gross benefits to be £325million, as set out in Ofgem's Final Impact Assessment.

- **Contractual Framework**

The introduction of a common set of transportation provisions, as set out in the UNC, 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.

- **Common Services and Systems**

By the introduction of an Agency to carry out centralised data related activities, transporters would be able to operate a common set of transportation services, governed by the same terms and conditions and implemented using a common suite of IT systems, thus ensuring that competition between shippers and between suppliers is not adversely affected - continuity with existing arrangements ensures disruption to Users is minimised.

¹² National Grid Transco – Potential Sales of gas distribution network businesses, Final Impact Assessment, Ofgem, November 2004

Disadvantages:

- As a result of the increase in the number of gas transporters, there would be an increase in the number of contractual interfaces in so far as there would be more parties for Users to contract for the provision and receipt of services. The additional contractual relationships would result in a requirement for more lines of security to be in place albeit for the same aggregate level of cover, an increased number of invoices and payments, and new contracts for the provision of Siteworks and connections. However, Transco would like to point out that the establishment of Agency, as mentioned above, offers considerable mitigation in this respect. Furthermore, competitive market developments in connections are likely to drive down costs and improve performance, serving to benefit customers and offset the impact of an increased number of interfaces in this respect.

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

This section summarises representations received in respect of the proposal to modify the Transco network Code into a Short Form Code as a key enabler in the creation of a multi-GT commercial framework, and summarises responses received in respect of the structure of that framework.

Representations have been received from the following companies:

British Gas Trading Ltd., BP Gas Marketing Ltd., EDF Energy, Total Gas & Power Ltd., E.ON UK plc, Gaz de France ESS (UK) Ltd., Maquarrie Gas Networks Ltd., RWE npower Plc, Shell Gas Direct Ltd., Scottish Power, Scottish and Southern Energy plc, and Statoil (U.K.) Ltd.

1 Support or otherwise

The essence of the proposal, that is, in the proposed multi-transporter environment, it is preferable for each transporter to have a short-form code, which incorporates by reference a common set of transportation terms, (the UNC), than for each transporter to have its own network code which would contain solely the transportation terms for its own network.

On this count, three respondents expressed a good degree of support for the proposal, with a further two respondents making more qualified statements of support. Of those respondents that oppose implementation (six), their reasons for doing so focused on four points of process.

They are:

- a) The treatment of the proposal as Urgent
- b) The (UNC) consultation process
- c) The (UNC) development process
- d) The basis by which the proposal “furthers the relevant objectives”

One respondent did not express a view on implementation but commented on the process points listed above.

a) Urgency

Virtually all respondents commented on the use of urgent modification procedures to permit the proposal to progress to consultation. Respondents commented that Transco had plenty of time to raise the proposal prior to consultation and that an unnecessary time constraint was therefore placed on the available development and consultation process by Transco's transaction timetable.

Transco response

Transco maintain that its request to use urgent procedures was appropriate and that all the reasons detailed earlier in this report are still valid, and in Transco's view, Ofgem's decision to grant urgent status was appropriate.

The use of urgent procedures allowed the proposal to be aligned to the Ofgem consultation on the UNC and the proposed licence modifications. It is Transco's view that the controlling factor in the consultation process was the development of the UNC, with this proposal being largely facilitative in nature, as the proposed Short Form Network Code contains no substantive terms and is required only to act a contractual link between Transco's Framework Agreement and the UNC. Hence, Transco believes that it was important that both consultations progressed in parallel. As such, it would have been inappropriate to consult on this proposal without the draft UNC being ready for consultation, as they are interdependent. To ensure a parallel consultation, it was necessary to tailor the timescales associated with the consultation on this proposal to the Ofgem consultation on the draft UNC, and Transco considered this best achieved using urgent procedures.

b) Consultation Process

Five respondents commented on the consultation process. Four respondents thought that the process in general could have been better handled with less reliance on parallel consultations for the UNC and this modification proposal. However, there were also more positive comments about the ability to align elements of the consultation to allow all aspects of the new commercial and regulatory framework to be considered in the round.

c) Development Process

The majority of respondents commented to some degree on the UNC development process, the majority expressing concerns over the volume of change and the speed at which the development work was undertaken. A number of shippers also raised the point that the development work should have been undertaken under the auspices of a development forum governed by the existing network code modification rules; some respondents referenced Modification Proposal 0719 as suitable for this purpose.

Transco response

Modification Proposal 0719 proposed that a Review Group be formed to provide a development vehicle for the conversion of Transco's Network Code into the UNC, and undertake similar work to that already underway in the UNC Development Forum; indeed the terms of reference of the Review and the Forum were very similar. It was not proposed that the group examine matters more structural in nature, such as the modification of Transco's Network Code into a Short Form Network Code. Hence, in Transco's view, Modification Proposal 0719 would not have provided an appropriate vehicle for this proposal.

d) Relevant Objectives

Four respondents commented specifically that they do not believe that implementation would further the relevant objectives of Transco's licence. Four respondents stated views to the contrary that they believed that implementation would ensure that the relevant objectives would be better facilitated.

Two shippers raised points in relation to the relevant objectives stated that change should be judged against the existing relevant objectives as laid down in Transco's current licence and should not be judged against licence conditions not yet in force.

One respondent stated that they believed that a special, temporary licence condition should have been included in Transco's licence to provide specific relevant objectives for this modification to be judged against.

Transco response

Transco would like to respond that it was under the current licence and relevant objectives that this proposal was raised and it is against the existing conditions that it should be judged. In any event the current licence conditions, and those proposed for transporters post hive-down, are analogous. On this point, Transco has, without prejudice, provided rationales as to why this modification better facilitates the relevant objectives against both sets of licence conditions in Section 3 to demonstrate this point.

With respect to the point raised by Eon concerning the introduction of a specific licence condition that referenced the transition from one to a new industry structure, Transco are of the opinion that there are two reasons why this would not have been appropriate course of action.

First, this additional relevant objective was added to the NGC licence because Ofgem concluded that it was essential that Elexon, as "custodian" of the BSC should be involved in assessing the relevant changes to the code and its associated systems that would be required as a consequence of extending its scope from England and Wales to GB. However, Elexon, by virtue of both the BSC (C1.2.2) and its Memorandum and Articles of Association, can only undertake activities provided for in the BSC. The original BSC dealt with balancing and settlement in England and Wales only, and so Elexon's vires was also so limited.

To allow Elexon to participate in the introduction of BETTA it was concluded that the Applicable BSC Objectives in the NGC licence would need to be modified in order that it would be possible for the Authority to conclude that a particular modification proposal to enable Elexon to participate in the implementation of BETTA would better facilitate the achievement of the Applicable BSC Objectives. The additional relevant objective enabled a BSC modification to be raised so as to extend the role of Elexon and then allowed the Authority to direct the change to the BSC. Once the BSC mod was implemented, Elexon was free to participate in BETTA implementation work. It was acknowledged that the additional objective that was inserted into the NGC licence was only needed for a transitional period and it so expired on BETTA Go Live.

The introduction of an "anticipatory" relevant objective for ASC 9 in respect of 0745 is not required since Transco's vires in contemplating the necessary changes to modify the Transco Network Code into Transco's Short Form Network Code is not limited either by its constitutional documents or by the Network Code in the same way that Elexon's was. The proposal is capable of being assessed against the existing relevant objectives in Transco's licence, and no additional objective is therefore needed within Transco's licence to facilitate the assessment of this modification proposal.

Secondly, there are fundamental differences between the introduction of BETTA and the introduction of the UNC, as facilitated by implementation of this proposal. The principal difference is that it was entirely consistent to place objectives in a licence when the introduction of the regime was required by statute; conversely the Authority only gave provisional consent to the divestment of parts of Transco distribution business on 27 January 2005. To have included licence conditions before that date would have prejudged the Authority's decision; to have done it after that date would have provided little time for the condition to have been effective.

In any event Transco believe that the existing relevant objectives are capable of judging the relative merits of the proposal. In terms of the BETTA related condition included in Eon's representation, had this been used as a model for a condition for inclusion in Transco's licence, Transco would reason that it had sufficient commercial drivers placed on it by the transaction to ensure that any changes are implemented in a "timely and effective" manner without resorting to a licence objective to that effect.

2 Transition Arrangements

One respondent commented that there should be clear and unambiguous arrangements in place for transporter obligations and responsibilities either side of hive-down.

Transco Response

The proposed contractual framework and transition arrangements ensure that network code obligations, as they relate to Transco's ongoing business, i.e., those relating to the four retained distribution networks and the NTS, would move seamlessly across the hive-down threshold. The proposed contractual framework facilitates this type of transfer of an ongoing business.

For the companies that would be created as part of hive-down, transition rules are required to ensure that transporter obligations, reflected in the services they provide to shippers, would be carried across hive down from Transco to the new company. To facilitate this, simple rules have been developed and included in the UNC Transition Document. Furthermore, Transco does not believe that is necessary to closeout the transferring business with shippers. Transco are of the opinion that the inconvenience that such a process would create would far outweigh any benefit; particularly as it is possible to transfer Transco's discontinuing business into new ownership and ensure that, in principal, shippers are unaffected. To facilitate this seamless approach for matters straddling hive-down, Transco and the new companies have agreed rules as part of the sales process that mean any transitional risk is borne between themselves as part of completion adjustments, ensuring that shippers remain whole.

For the retained business, it literally would be "business as usual". For the transferring business, from an operational perspective, the situation would be very similar, as the majority of operational points of contact would be with the same after hive down as before, particularly with the introduction of transporter agency.

The proposed structure avoids the requirement to terminate any existing agreements, thereby avoiding any requirement for run-off arrangements of the type required for the transportation agreements in operation prior to the inception of the Network Code in 1996.

3 Legal drafting

Two respondents commented that they had not seen the text of Transco's short form network code.

Transco Response

This is not the case, as a version of the proposed draft text was circulated with the proposal. Section 19 of this report contains the refined version of Transco Short Form Code and is now complete with operative text.

4 Merits of Short Form Codes

Seven shippers commented on the use of Short Form Network Codes to give effect to the UNC. Many commented that it was conceivable that this contractual framework allowed for divergence, over time, of the transportation arrangements of the various network operators, as the Short Form Network Codes would be modifiable. However, there was also qualified support for this framework as it a pragmatic solution to the preservation of common terms across a divested structure.

Transco comment

Divergence could only occur where it could be demonstrated that the implementation of a modification proposal would serve solely to further the relevant objects of a limited number of transporter licences

5 Miscellaneous

Two respondents raised specific comments in their representations not addressed elsewhere in this report: first, one respondent pointed out that the new licence condition provided a modification route which would allow the UNC to be modified without going through the UNC governance procedures; and secondly, one respondent pointed out that it expected the modification panel to be very busy over the coming months.

Transco response

The licence condition permitting modification to a Network Code (and the UNC in the new licence) outside the governance procedures is an existing condition and carried forward to the new licence.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

As part of the hive-down process it is of paramount importance that safety is not compromised. In order to ensure this is the case, Transco's Safety Case has been amended and new Safety Cases developed for the hived-down companies, and these were approved by the HSE on 15 April 2005.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation is not required with regard to any such proposed change.

14. Programme of works required as a consequence of implementing the Modification Proposal

The system changes identified in section 6 would be implemented as follows:

First, in the case of the system change controlling accession, this would be implemented immediately; secondly, in the case of the file formats for invoicing, this would be implemented at a point in the invoicing cycle that allows Transco's residual charges to be invoiced as Transco and transportation services supplied by the new hive-down companies to be billed accordingly. The introduction of this change is ongoing and is being co-ordinated through the governance of the UK-Link committee.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

No action is required with respect to Transco's Network Code. However, Users would be invited to sign Framework Agreements with each of the four subsidiary companies (anticipated to become licensed transporters on the appointed day) such that current arrangements would continue in respect of the conveyance to supply points located on DNs whose assets would move to these subsidiaries on the appointed day.

Such events would take place in accordance with the sequence of events laid out in section 9.

16. Recommendation concerning the implementation of the Modification Proposal

For the reasons Transco has identified in sections 3 and 10, Transco recommends implementation of the proposal.

17. Restrictive Trade Practices Act

If implemented this proposal would constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Delete the Network Code and replace with text to read as follows:

1 Network Code

This document is the network code of Transco plc prepared pursuant to Standard Special Condition A11(3) of the Transporter's Licence.

2 Interpretation

In this document:

"Transporter" means Transco plc registered in England with number 2006000 whose registered office is at 1-3 Strand, London WC2N 5EH a corporation organised and existing under the laws of England.

"Transporter's Licence" means the gas transporter's licence granted or treated as granted to the Transporter under Section 7(2) of the Gas Act 1986, as from time to time in force;

"Network Code" means this document as from time to time modified in accordance with the network code modification procedures set out in the Uniform Network Code or the Transporter's Licence;

"Uniform Network Code" means the Uniform Network Code prepared by the Transporter (together with the other relevant gas transporters) pursuant to Standard Special Condition A11(6) of the Transporter's Licence.

3 Provisions of Network Code

The Network Code comprises the provisions set out in the Uniform Network Code, which are hereby incorporated into this document.

Signed for and on behalf of Transco.

Signature:



Chris Train

DN Sales Implementation Director

NGT

Date: 18 April 2005

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0745**, version **1.0** dated **18/04/2005**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **1.0**

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.