

**July 2002**

**Regulatory issues arising from the  
merger of National Grid Group plc and  
Lattice Group plc to create National  
Grid Transco plc**

**Initial proposals**

## Executive summary

In April 2002, National Grid Group plc and Lattice Group plc announced their intention to merge to create National Grid Transco plc. Ofgem published a consultation paper in May 2002 considering the competition and regulatory issues raised by the merger. Taking into account the responses it received to that consultation Ofgem provided its advice to the Director General of Fair Trading on the competition issues arising from the merger. On 2 July 2002, the Secretary of State cleared the merger.

This document summarises the responses received to the May 2002 consultation and provides an additional opportunity for parties to comment on the regulatory issues raised, in the first instance, by the merger. The document also seeks views on proposed regulatory solutions.

In general, respondents considered that the proposed merger did not raise competition issues but that further consideration needed to be given to a number of regulatory issues.

Taking into account those responses, this document focuses on four main areas:

- ◆ the increased potential for information sharing and the scope of the combined group to take unfair advantage through its operation of both networks;
- ◆ the vertical separation of the combined group;
- ◆ the effect of the merger on security of supply issues; and
- ◆ the synchronisation of Ofgem's planned work programmes in a number of areas.

### Information and transparency

Respondents raised concerns regarding the interaction between NGC and Transco's respective system operator roles and the need to ensure transparency, where appropriate, in system operation. Ofgem's initial view is that the existing framework appears to be sufficient to prevent the combined group gaining an unfair advantage over others in relation to their respective system operator roles. In view of concerns raised

by respondents, Ofgem will seek to address issues relating to the interaction between the two system operator roles and information transparency in its ongoing work programme. For example, in preparing and implementing a new system operator incentive scheme for NGC from April 2003, Ofgem will take into account any interactions between NGC and Transco's respective system operator incentive schemes.

### Vertical separation

Ofgem considers that vertical separation is important in promoting confidence in the operation of the gas and electricity wholesale markets. This document focuses upon two specific issues in relation to vertical separation: the sale and purchase of gas and electricity by the combined group; and National Grid Group plc's ownership of EnMo Limited, the operator of the On-the-day Commodity Market (OCM) in gas through which gas shippers, suppliers and Transco can buy and sell gas. This document proposes a number of measures in order to address issues of vertical separation of the combined group:

- ◆ ringfencing EnMo Limited which operates the OCM so that neither Transco nor NGC is able to access confidential information held by EnMo Limited, other than on the same basis as third parties;
- ◆ modifying Transco's gas transporter licence to prevent any related undertakings or affiliates of Transco from purchasing and selling gas other than with Ofgem's consent, or for the purposes of balancing their network (this will align Transco's licence with existing restrictions in place for NGC in relation to the buying and selling of electricity); and
- ◆ issuing specific time limited consents that will allow the combined group to retain, appropriately ringfenced, the very small amount of electricity generation presently undertaken by Lattice plc (with any future requests for consent being considered on an individual basis).

### Security of supply

Ofgem's initial view in its May 2002 consultation, was that the merger could have a positive effect on the security of supply through, for example, increased joint working by NGC and Transco but that it was also necessary to consider whether there were any detrimental effects. Ofgem has considered issues in relation to the financial ringfencing

of NGC and Transco and the importance of managerial focus. This document sets out proposals to revise the financial ringfence of both companies removing, where appropriate, any differences between the two companies' financial ringfences and updating the obligations for both companies to bring them into line with the obligations for electricity distribution businesses which were revised in October 2001.

#### Synchronisation of regulatory work programmes

Generally, Ofgem does not consider that it is necessary to alter the timing or content of Ofgem's planned work programmes on transmission operator price controls, system operator price controls and incentives or the potential disposal of, and future regulatory regime for, Transco's Liquefied Natural Gas facilities. However, Ofgem will be expanding its planned work on system operator price controls and incentives to consider the operation of and interaction between the licensees respective incentive schemes within the combined group. In addition, while Ofgem does not consider that it is necessary to change the length of the existing transmission operator price controls for either company following the merger, it is seeking views on whether in future it would be appropriate to synchronise the timing of the transmission operator price controls for NGC and Transco.

Comments on this document are invited by 28 August 2002.

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# 1. Introduction

## *Purpose of this document*

- 1.1 On 2 July 2002 the Secretary of State for Trade and Industry (Secretary of State) cleared the proposed merger of National Grid Group plc (National Grid) and Lattice Group plc (Lattice) to create National Grid Transco plc (NGT). This document sets out a number of areas where Ofgem considers that regulatory action may need to be taken to prepare for the combining of NGC and Transco within one group.
- 1.2 Views are invited from interested parties on the regulatory issues identified by Ofgem and, where applicable, Ofgem's proposed regulatory solutions. In addition, Ofgem would welcome comments on any other regulatory issues that may arise as a result of the merger.

## *Background*

- 1.3 Ofgem, which supports the statutory functions of the Gas and Electricity Markets Authority ('the Authority'), has a non-statutory role in relation to the application of the UK and European merger control rules<sup>1</sup>, providing confidential advice to the Director General of Fair Trading (DGFT) on any competition issues that may arise as a result of actual and proposed transactions in the GB gas and electricity sectors.
- 1.4 On 22 April 2002, National Grid, the owner of The National Grid Company plc (NGC), and Lattice, the owner of Transco plc (Transco), announced their intention to merge to form NGT. On 16 May 2002, Ofgem published<sup>2</sup> a consultation paper on the proposed transaction which:
  - ◆ considered the competition issues that might arise if the proposed transaction was allowed to proceed (in order to provide advice to the DGFT on whether the transaction should be allowed to proceed); and

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<sup>1</sup> In relation to UK merger control the relevant legislation is the Fair Trading Act 1973. In relation to European merger control the relevant legislation is the European Merger Control Regulation (Council Regulation 4064/89 as amended by Council Regulation 1310/97).

<sup>2</sup> 'Proposed merger of National Grid Group plc and Lattice Group plc to create National Grid Transco plc: a consultation paper': Ofgem May 2002.

- ◆ gave preliminary consideration to some of the regulatory issues that might arise if the transaction was allowed to proceed (which Ofgem would seek to address as part of its ongoing regulation of the gas and electricity sectors).
- 1.5 Ofgem received 16 responses to its May 2002 consultation<sup>3</sup>. Largely, respondents took the view that while the proposed transaction might not raise significant competition issues there were a number of regulatory issues that would need to be addressed if the transaction was allowed to proceed. A list of non-confidential respondents to the consultation can be found in Annex A.
- 1.6 Following consideration of the responses to the May 2002 consultation paper, Ofgem provided advice to the DGFT on the competition issues arising from the transaction.
- 1.7 Following the Secretary of State's decision on 2 July 2002 to clear the merger, Ofgem is now taking forward work on the regulatory issues arising from the merger.

### ***Structure of the document***

- 1.8 Chapters 2 to 5 give further consideration to the regulatory issues raised by the merger and invite views, where applicable, on Ofgem's proposed regulatory solutions. Chapter 6 explains Ofgem's timetable for addressing these regulatory issues and invites views on any other regulatory issues that may arise. Annex A contains a list of non-confidential respondents to the May 2002 consultation. Annex B sets out a draft licence condition on EnMo Limited. Annex C sets out the financial ringfence provisions for NGC, Transco and the electricity distribution licensees.
- 1.9 On 12 April 2002, Ofgem issued a notice under section 23 of the Gas Act 1986 (the Gas Act) in respect of proposed modifications to Transco's gas transporter licence to introduce, with effect from 1 April 2002, new price controls and system operator (SO) incentives for Transco. Ofgem is currently considering the responses that it has received to this consultation.

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<sup>3</sup> This figure includes two responses which were received after Ofgem's advice had been submitted to the DGFT. These responses have been taken into account in preparing this consultation paper.



- 1.10 Ofgem has taken account of these proposals in considering the potential regulatory issues arising out of the merger and possible regulatory solutions in order to provide respondents with a high level overview of the incentives which NGC have and Transco may have if the proposed modifications are implemented. This has been done to promote debate and does not fetter the Authority's discretion in respect of these modification proposals. All comments in this paper regarding Transco's price control and SO incentives should be considered in the light of this statement.

### ***Timetable***

- 1.11 Ofgem intends to bring forward licence modifications to address the regulatory issues raised by the merger in autumn 2002<sup>4</sup>. In order to allow Ofgem to meet this timetable responses are requested by Wednesday 28 August 2002. Responses can be made either by post, fax or email and should be addressed to:

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9 Millbank  
London  
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Email: [lisa.vango@ofgem.gov.uk](mailto:lisa.vango@ofgem.gov.uk)

### ***Contact***

- 1.12 If there are any questions regarding this document please contact, in the first instance, Lisa Vango on 020-7901-7178.

### ***Confidentiality***

- 1.13 In accordance with Ofgem's normal practice, responses to this consultation will be made publicly available, through the Ofgem Library and on the Ofgem website. Respondents should mark any part of their response (or the whole

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<sup>4</sup> These modifications will be made using section 11 of the Electricity Act 1989 (the Electricity Act) (in relation to NGC's electricity transmission licence) and section 23 of the Gas Act (in relation to Transco's gas transporter licence).

response) which is to remain confidential, if this is the case, and where possible should consign any confidential material to appendices.

## 2. Access to information

### *May 2002 consultation*

- 2.1 Ofgem's May 2002 consultation document sought views on whether the increased potential for information sharing between the two network businesses owned by National Grid and Lattice, which would result from the merger, might operate to the disadvantage of other parties and, if so, to what extent steps may be required to address this.

### *Background*

- 2.2 At present some exchange of information takes place between NGC and Transco in relation to network issues. For example, NGC receives information from Transco about the likelihood of Transco interrupting the supply to gas-fired power stations. Given the increasing interactions between the gas and electricity sectors (in 2001/02 gas fired generation plant accounted for 34% (23,080 MW) of total England and Wales generation capacity<sup>5</sup> and 37% of total England and Wales generation output) such sharing of information can be beneficial to the operation of the two networks.

### *Discussion*

#### *Respondents' views*

- 2.3 Almost all of the respondents to the consultation raised some concerns regarding the increased access to information that NGC and Transco would have if the merger was cleared. Those concerns focused generally on the extent to which NGC and Transco, as the SOs, might be able to utilise information to the disadvantage of others or to maximise the collective profits of NGT.
- 2.4 The concerns raised by respondents included concerns that if, through the increased availability of information, NGC and Transco are able to balance their systems more efficiently, this could disadvantage gas shippers/suppliers and electricity generators (the reduction in balancing costs being offset by a reduction in profits for other market players). Linked to this were concerns that

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<sup>5</sup> Source: 2002 NGC Seven Year Statement.

advance warning of constraints on the other network might enable NGC or Transco to forward-buy/sell gas or electricity at a more advantageous price in order to balance the network. There were also concerns expressed regarding NGC and Transco's increased ability to co-ordinate maintenance schedules and other interruptions and regarding increased opportunity for arbitrage between the two systems in general.

- 2.5 Several respondents commented that it was important that market information was as transparent as possible and that, where appropriate, it was shared with all market participants in a timely manner.
- 2.6 Some respondents noted the existence of anti-discrimination licence obligations and other measures but took the view that the existing arrangements would be inadequate to prevent or detect all of the profit maximising or anti-competitive behaviour that there would be scope for if the merger was allowed to proceed.
- 2.7 Several respondents commented that it was important to review the SO incentive schemes of both companies as soon as possible to ensure that they do not operate to the disadvantage of others and to ensure that they do not encourage NGT to discriminate between the two network businesses in any way.
- 2.8 Many respondents expressed general concerns about the potential for discrimination represented by the increased accessibility of information, but did not quantify how NGC and Transco might be able to use the increased information in such a way as to gain an unfair advantage over others.
- 2.9 National Grid and Lattice took the view that the potential for information sharing that would result from the proposed merger would not give the combined group an unfair advantage because the use of information by each party (as SO) is regulated by Ofgem and through industry agreements and because NGC was prohibited from engaging in speculative trades (with similar prohibitions proposed by Ofgem for Transco on 12 April 2002<sup>6</sup>). In addition, National Grid and Lattice took the view that current safeguards in place for NGC (and the similar safeguards proposed by Ofgem for Transco on 12 April 2002<sup>7</sup>), including

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<sup>6</sup> See paragraphs 1.9 and 1.10.

<sup>7</sup> See paragraphs 1.9 and 1.10.

requirements that all information received during timescales when other parties could still act upon that information be made available to the market; the holding of regular operational fora for market participants to question the SOs about their balancing actions; and the annual reporting on and audit of balancing actions, would be sufficient to address any concerns. They also took the view that the Financial Services Authority's (FSA) Code of Market Conduct, through which the FSA can impose financial penalties for market abuse, would address concerns.

- 2.10 In addition, National Grid and Lattice took the view that the increased availability of information as a result of the merger would bring benefits to customers, as improvements in efficiency in performing their respective SO roles would lower balancing costs, with the resulting savings being passed back to customers.

*Ofgem's views*

- 2.11 Ofgem recognises that as a result of the merger, and subject to the rules set out in the Balancing and Settlement Code (BSC) and the Network Code, the combined company may have access to information not previously available to either NGC or Transco as separate businesses. As a result of this NGT may be able to balance both systems more effectively than would otherwise have been the case, and at a lower overall cost (as incentivised by the respective SO incentive schemes). This may reduce the balancing services payments received by some participants in the gas and electricity wholesale markets. However, in Ofgem's view, this would benefit consumers immediately through a reduction in the balancing costs and in the longer term through the review and re-setting of the SO incentive schemes and does not, in itself, raise concerns for Ofgem given the resulting benefits to customers and the existing regulatory framework within which NGC and Transco fulfil their SO roles, as set out below.
- 2.12 However, in view of concerns raised by respondents Ofgem will, as part of its planned work on SO price controls and incentives (considered in Chapter 5 of this paper), consider the operation of the two incentive schemes and any interaction between them following the merger and will seek to address any issues identified as part of that work.

- 2.13 During preparations for the introduction of the New Electricity Trading Arrangements (NETA) and the New Gas Trading Arrangements (NGTA), a number of participants expressed concern that NGC and Transco would be able to trade on their own account, taking advantage of market sensitive information they had available to them through their roles in balancing their respective networks. It has been suggested that as a result of the merger, the combined company will now be able to exploit this position over both networks.
- 2.14 It is Ofgem's view that the present regulatory framework for electricity already prevents NGC unfairly taking advantage of market sensitive information. Special Condition AA4 (Licensee's procurement and use of balancing services) of NGC's electricity transmission licence prevents NGC from engaging in speculative trades and from discrimination in the procurement or use of balancing services. Similar restrictions were proposed in relation to Transco on 12 April 2002<sup>8</sup>, in particular proposed Special Condition 26 (Prohibited procurement activities). In addition, Special Condition AA4 (Licensee's procurement and use of balancing services) for NGC (and Ofgem's proposals in respect of Special Condition 27 (Licensee's procurement and use of system management services) for Transco<sup>9</sup>) require regular auditing of the balancing principles statements and regular operational fora are held to explain balancing decisions made by the respective SOs.
- 2.15 Special Condition AA4 of NGC's licence and proposed Special Condition 27 of Transco's licence<sup>10</sup> provide that the companies' statements on balancing activities will be reviewed by the companies as and when required but at least on an annual basis. Any changes that the companies propose to make must be approved by the Authority. Part of this process will include the companies consulting with market participants and interested parties. As part of that consultation exercise Ofgem will be looking for the companies to address any issues that arise concerning SO information provision as a consequence of the merger. Ofgem will also expect NGC and Transco to make use of their respective operational and balancing services fora to discuss any interaction issues between the two networks. These fora are open to all interested parties.

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<sup>8</sup> See paragraphs 1.9 and 1.10.

<sup>9</sup> See paragraphs 1.9 and 1.10.

<sup>10</sup> See paragraphs 1.9 and 1.10.

- 2.16 Ofgem also has concurrent powers with the DGFT, as a competition authority, in relation to anti-competitive agreements or behaviour under the Competition Act 1998. These powers may allow Ofgem to take action if the activities of the merged entity in this or any other respect are shown to have an anti-competitive effect.
- 2.17 Ofgem is speaking with the FSA and the Treasury concerning any implications in relation to the Financial Services and Markets Act 2000 exemptions for Transco, NGC and EnMo. The parties will need to address these issues separately with the FSA and the Treasury.

### ***Ofgem's proposals***

- 2.18 Ofgem does not intend to make any additional changes to the licences held by NGC and Transco in respect of the accessibility of information, and the transparency of its use, as a result of the merger, other than the measures that Ofgem proposes in Chapter 3 to reinforce the vertical separation of the businesses.
- 2.19 In addition, Ofgem will be considering the operation of and interaction between NGC and Transco's respective SO price controls and incentives within the NGT group, as part of its present work on SO price controls and incentives (as discussed in Chapter 5).

### 3. Vertical separation

#### *May 2002 consultation*

- 3.1 Both National Grid and Lattice are engaged in other activities in addition to their main businesses of electricity transmission and gas transportation. In its May 2002 consultation, Ofgem sought views on whether these other activities raised potential competition concerns and on the most appropriate solution for dealing with any concerns.
- 3.2 The purpose of this Chapter is to set out the views of respondents to the May 2002 consultation and to seek views on the proposed regulatory solutions for dealing with NGT, in relation to:
- ◆ purchasing and selling gas and electricity other than for the purposes of balancing their networks; and
  - ◆ operating the OCM, through its ownership of EnMo.

#### *Purchase and sale of gas and electricity*

##### **Background**

- 3.3 Lattice, through Lattice Energy Services, operates CHP plants with a generation capacity of 27MW. These plants are located at Cleveland, Hertfordshire and Bristol. In order to operate two of these facilities Lattice also purchases gas on its own account. Lattice has advised Ofgem that these schemes aim to match the supply of heat and electricity to on-site demand with no export to the local distribution network.
- 3.4 In addition, Lattice has on-site back-up generation capacity at a number of its premises but with the exception of St Mary Cray it does not sell any surplus generation from those sites. Transco's Local Distribution Zone (LDZ) office at St Mary Cray in Kent includes a turbo-expander with a generating capacity of approximately 1 MW. Turbo-expanders are able to generate electricity from the pressure differentials which exist between Transco's national transportation system (NTS) and the LDZs. Lattice have advised Ofgem that the plant is operated passively i.e. neither of these pressures is set to manage the amount of



electricity that is generated. Any output from St Mary Cray which is not used by the office site is sold pursuant to a separate agreement to an electricity supplier (for a fixed price per KWh regardless of when it is generated) and is delivered into the local distribution network.

- 3.5 Lattice sells surplus electricity from four Liquified Natural Gas (LNG) sites which are located at Isle of Grain, Dynevor Arms, Partington and Avonmouth. This electricity is sold for a fixed price to an electricity supplier (under contract) and is delivered into the local distribution networks. The maximum power delivered is 18.3MW.
- 3.6 Electricity is also generated at the Advantica site in Loughborough for use at that site (i.e. by Advantica and other companies occupying property there). No electricity is exported from the site.
- 3.7 At present, NGC's electricity transmission licence does not allow NGC nor its affiliates or related undertakings to buy or sell electricity except with Ofgem's consent<sup>11</sup> or by way of the procurement or use of balancing services.
- 3.8 In addition licence conditions consulted on as part of the recent process to introduce SO incentives for Transco will, if introduced, prevent Transco or an affiliate (when that affiliate is acting on Transco's account) from purchasing or selling gas other than for the purpose of facilitating balancing and constraint management<sup>12</sup>.

## **Discussion**

### *Respondents' views*

- 3.9 Some respondents that commented on Lattice's electricity generation interests took the view that electricity generation interests should not be allowed within the combined group. Other respondents commented that if divestment was not to be taken forward it would be necessary, at a minimum, to ringfence the generation interests from NGC. Others were not overly concerned about the inclusion of Lattice's electricity generation within the combined group, given the

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<sup>11</sup> Standard condition C2 of the standard licence conditions for electricity transmission licences. Special condition AA3 (Supplementary prohibited activities) provides that the prohibition does not apply to the purchase of electricity from the Kielder hydro-electric generating station.

<sup>12</sup>See paragraphs 1.9 and 1.10.

small scale of their present activities, but considered that no expansion of their existing capacity should be allowed. Concerns were raised that if generation interests were to be retained within the combined group it would be necessary to ensure that NGC, in its role as SO, could not contract within group for the provision of balancing services.

- 3.10 National Grid and Lattice recognise that the prohibition on the ownership of generation interests in NGC's licence needs to be addressed if the generation activities are to be allowed to continue. They argue that, regardless of whether Lattice's existing CHP interests are allowed to remain within the combined group, Ofgem will need to give consideration to situations in which the ownership of electricity generation interests by the combined group will be allowed. For example, Lattice is continuing to review the economics of turbo-expanders (whereby electricity is generated as a by-product of gas transportation activity) in the light of technological advances and development of the commercial framework for generation. If proposals for expansion of this activity were to be brought forward they argue that there would be a strong argument for it to be permitted given that the process utilises energy which is presently wasted in conveying gas and so is very energy efficient.

*Ofgem's views*

- 3.11 It is Ofgem's view that vertical separation is important in promoting confidence in the wholesale gas and electricity markets. Any vertical integration of the network businesses of NGC and Transco might lead to a loss of confidence in the independence of NGC and Transco in developing and in particular balancing their respective networks, which could have a detrimental effect on the operation of the wholesale markets. While this issue was raised in Ofgem's May 2002 consultation in relation to the purchase and sale of electricity, concerns over vertical separation apply equally to the purchase and sale of gas.
- 3.12 Ofgem considers that it is particularly important that none of NGC, Transco nor any of their affiliated or related undertakings should be allowed to be involved in the purchase or sale of gas or electricity, except with the consent of Ofgem or, as permitted by their respective licences, for SO balancing purposes. Ofgem proposes to allow Lattice to retain within the combined group all of the

electricity generation plant that it currently operates provided that they are appropriately ringfenced (including preventing the sale of generation output and other generation services to any company within the combined group). For the avoidance of doubt this proposal only relates to electricity generation plant that is currently operational.

- 3.13 Ofgem proposes to grant time limited consents to these existing operations. This decision has been made having taken into account a number of factors, including: the very small-scale of Lattice's existing interests in the purchase and sale of electricity as described above; the fact that all its generation is connected to distribution networks and not the transmission system; and the environmentally beneficial nature of the generation being undertaken.
- 3.14 In granting a consent allowing the continued ownership of the three CHP plants Ofgem may also need to give NGT a further consent allowing gas to be purchased in order to operate the CHP plants.
- 3.15 As a general principle, Ofgem does not consider that it would be appropriate for NGT to increase its generation interests beyond the plant that it currently holds. Ofgem will, of course, consider future requests for consent on a case by case basis, but considers that the importance of vertical separation in promoting confidence in the wholesale gas and electricity markets is likely to outweigh the possible benefits of allowing further generation interests in most situations. Accordingly there can be no presumption that further consents will be forthcoming in any case.

### **Ofgem's proposals**

- 3.16 To implement the policy described above, Ofgem proposes:
- ◆ a modification to proposed Special Condition 26 of Transco's licence (if the modification proposal published by Ofgem on 12 April 2002 is made<sup>13</sup>) to prevent related undertakings as well as affiliates from buying or selling gas except with Ofgem's consent, whether as principal or agent. This would bring Transco's licence fully into line with NGC's licence which already prevents NGC and affiliates and related

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<sup>13</sup> See paragraphs 1.9 and 1.10.

undertakings from buying or selling electricity without Ofgem's consent, except for SO balancing purposes;

- ◆ a modification to Special Condition AA3 (Supplementary prohibited activities) of NGC's licence to allow Ofgem to issue a consent for the licensee and/or any affiliate or related undertaking to purchase or sell electricity consistent with SLC C2 (Prohibited activities) of its licence which already allows for consents to be issued;
- ◆ issuing a consent under the revised Special Condition AA3 and under SLC C2 of NGC's licence to allow NGT to retain all of Lattice's existing generation capacity on the terms specified in the consents. The consent will among other things identify the specific sites and generating capacity allowed, be time limited, ring fence the activity to prevent information about the generation of electricity within the group being made available to NGC and will prevent sale of the output/other generation services from the plant to any company within NGT. If the activities of any member of the combined group breach the terms of the consent, this will constitute a breach of NGC's licence; and
- ◆ issuing a consent under proposed Special Condition 26 of Transco's licence (if the modification proposal published by Ofgem on 12 April 2002 is made<sup>14</sup>) to allow Lattice to purchase gas for the purpose of operating its three CHP facilities, on the terms specified in the consents. The consent will among other things identify the specific sites and maximum volumes, be time limited and ringfence the activities to prevent information flows between the subsidiary operating the CHP facilities and the rest of the group. If the activities of any member of the combined group breach the terms of the consent this will constitute a breach of Transco's licence.

## *EnMo*

### **Background**

- 3.17 National Grid, through its subsidiary EnMo, operates the OCM, which is a trading platform through which shippers and Transco can buy and sell gas. The OCM is used by shippers to buy and sell gas in order to balance their positions. Transco, as SO, also buys and sells gas on the OCM to balance the system. EnMo does not buy and sell gas itself.

### **Discussion**

#### *Respondents' views*

- 3.18 Some respondents commented on National Grid's ownership of EnMo and whether it raised any competition concerns. All of those respondents took the view that NGT should either be required to divest EnMo (although some noted that National Grid were currently seeking a buyer for EnMo) or that as a minimum EnMo should be suitably ringfenced to prevent Transco having access to gas trading information.
- 3.19 National Grid and Lattice recognise the concern that Transco could benefit from access to confidential information held by EnMo as the operator of the OCM, but take the view that their existing obligations to avoid discrimination and on the use of information should be sufficient to address these concerns. In addition, they take the view that any such action would not make commercial sense given that it would compromise EnMo's credibility, resulting in a loss of custom for EnMo, and that the consequent illiquidity in the OCM would disadvantage Transco in its role as SO. National Grid and Lattice take the view that any residual concerns could be addressed through regulation.

#### *Ofgem's views*

- 3.20 While the operation of a trading platform is not a breach of either company's licence (Transco does frequently trade through EnMo), it is Ofgem's view that the merger may give rise to concerns that Transco would be able to access information about the prices and volumes traded by other participants.

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<sup>14</sup> See paragraphs 1.9 and 1.10.

However, Ofgem recognises that the parties have a vested interest in preventing confidential information being accessed by Transco, since failure to do so would reduce the commercial viability of EnMo and may make it more expensive for Transco, as SO, to balance its network.

### **Ofgem's proposals**

- 3.21 In order to address concerns regarding the accessibility of information held by EnMo, Ofgem is proposing to ringfence EnMo from the two network businesses to prevent the transfer of information from EnMo to NGC and/or Transco. This proposal would be implemented via a new licence condition to be included in the licences of both NGC and Transco.
  
- 3.22 A draft of the proposed licence condition is set out in Annex B.

## 4. Security of supply

### *May 2002 consultation*

- 4.1 In its May 2002 consultation Ofgem sought views on whether the proposed transaction raised any issues in relation to the security of electricity and gas supplies and more generally the operation of both networks.
- 4.2 The continued effective operation of the network businesses is fundamental to ensuring that producers are able to bring their energy to the marketplace and in ensuring that supplies can be delivered to customers. NGC is the sole electricity transmission licensee in England and Wales. Transco owns and operates the high pressure NTS network in GB and owns and operates the large majority of the low pressure gas distribution system in GB. As such the security of electricity and gas supply within GB is to a large degree wholly dependent upon the networks operated by National Grid and Lattice.
- 4.3 In its May 2002 consultation, Ofgem recognised that the merger could bring operational synergies, arising through the sharing of expertise and best practice between the two network businesses and through increased joint working (such as in relation to emergency planning), which could bring benefits to all customers in terms of increased system security and performance. Nevertheless, Ofgem took the view that in considering the potential effects of the proposed transaction, it was also necessary to consider whether the inclusion of the two network businesses within a combined group could have any detrimental effects on security of supply.
- 4.4 Following consideration of the responses received to the May 2002 consultation Ofgem considers that these issues can be broadly considered under two headings:
- ◆ financial ringfencing; and
  - ◆ managerial focus.

## *Financial ringfencing*

### **Discussion**

- 4.5 In its May 2002 consultation, Ofgem commented that concerns might arise that, if the merger was cleared, an event such as the failure of the network businesses' parent company would now impact on both of the network businesses rather than just one of the network businesses.

### *Respondents' views*

- 4.6 A number of respondents commented on the need to ensure the financial stability of the network businesses which must be able to continue to finance the operation of their networks. Some of those respondents took the view that it was necessary to ensure that the financial ringfencing of the two network businesses was sufficient (with one taking the view that the existing ringfences were sufficient, subject to the need for modifications to reflect the establishment of NGT). Several respondents commented that it might be appropriate to strengthen NGC and Transco's current licence obligations in relation to credit ratings.
- 4.7 National Grid and Lattice took the view that the existing financial ringfencing provisions were sufficient.

### *Ofgem's views*

- 4.8 The network businesses of NGC, Transco and the electricity distribution businesses are currently 'ringfenced' from other activities that may be carried on within their respective groups<sup>15</sup>. This financial ringfence is designed to ensure that each licensee has available to it at all times the financial resources it requires to carry on its network business, and that these are not exposed to inappropriate risks nor diverted to other purposes.
- 4.9 Following the merger NGC and Transco will continue to be financially ringfenced from each other as well as from the rest of the NGT group. Generally,

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<sup>15</sup> These ringfencing conditions are included in NGC's electricity transmission licence as special conditions and in Transco's gas transportation licence as standard licence conditions, amended standard licence conditions and special conditions.



it is Ofgem's view that these existing restrictions are sufficient within the combined group.

- 4.10 Special Condition 4 (Credit rating of licensee) of Transco's gas transporter licence and Special Condition AA9 (Credit rating of licensee) of NGC's electricity transmission licence require that the licensee use all reasonable endeavours to maintain an investment grade credit rating. An investment grade credit rating is defined in both licences as BBB- by Standard & Poor's or Baa3 by Moody's Investor Services (or an equivalent rating). Ofgem has considered respondents' suggestions that NGC and Transco's existing credit rating obligations should be strengthened but takes the view that the existing obligations placed upon NGC and Transco are sufficient.
- 4.11 While Ofgem generally considers the existing financial ringfencing provisions to be sufficient, it proposes that a series of licence modifications will be made to NGC and Transco's licences to:
- ◆ bring NGC's and Transco's licences (where appropriate) into line with each other; and
  - ◆ amend both NGC's and Transco's licences (as far as appropriate) to bring them into line with obligations that were introduced in October 2001 for all electricity distribution licensees and which represents Ofgem's current thinking with respect to financial ringfencing. NGC's obligations are, to a large extent, identical to the equivalent provisions of electricity distribution licences and will require only a small number of amendments. A larger number of amendments will be required to Transco's licence to update its ringfencing obligations, which were introduced in 1999.
- 4.12 It will, of course, remain open to Ofgem to seek further modification to the financial ringfencing provisions in the future if changing circumstances indicate that this would be appropriate.

### **Ofgem's proposals**

- 4.13 As explained above, Ofgem proposes to modify NGC's and Transco's licences to align their existing financial ringfencing obligations and, where appropriate, to

bring them into line with the electricity distribution licence obligations which were introduced on 1 October 2001. A table of the existing financial ringfencing obligations for NGC, Transco and the electricity distribution businesses is set out at Annex C.

- 4.14 In one respect however, Ofgem does not propose to bring the licences of NGC and Transco into line with the electricity distribution licences. In the licence conditions on 'Restriction on activity and financial ringfence' provision is made for all licensees to carry on activities not authorised by their licence where these are in the aggregate immaterial, as judged by specific tests. One such test relates to the scale of the licensee's investment in such other activities. Investment for these purposes is defined, broadly speaking, as the cumulative total expenditure incurred or committed. No account is taken of income received. This definition makes it increasingly difficult for a licensee to carry on such activities as time passes, the more so according to the success encountered. This might prevent the licensee undertaking activities that could bring benefits to electricity or, as the case may be, gas consumers. Accordingly, it is proposed to amend in both licences the definition of investment for these purposes to take account of income generated from the relevant activities to the extent received by the licensee<sup>16</sup>. Similar changes will be proposed for the electricity distribution licences in due course.

### ***Managerial focus***

#### **Discussion**

- 4.15 National Grid has recently completed several acquisitions in the US where it holds interests in the transmission, distribution and supply of gas and electricity. It was widely reported that one of the shareholder benefits that would result from the merger would be the increased potential for further acquisitions in the US. In its May 2002 consultation Ofgem sought views on whether such acquisitions might raise concerns regarding the extent to which managerial resources could be diverted away from the regulated businesses to other areas of the group, in particular to the US business.

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<sup>16</sup> This principle is already reflected in Transco's licence but Ofgem proposes that the drafting currently included in the Transco licence will be amended in the interests of greater clarity.

4.16 Such reassignment of staff responsibilities or focus might cause concerns if it affects adversely the operation of the regulated GB businesses, for example, if key personnel from NGC or Transco were being increasingly employed on overseas group operations. Similarly such acquisitions may raise concerns regarding the allocation of group resources to the regulated GB businesses, for example, the extent to which certain businesses within the combined group might receive preferential treatment in the allocation of group resources.

*Respondents' views*

4.17 A number of respondents commented on the need to ensure that sufficient managerial resources would be devoted to the GB regulated businesses. Several respondents took the view that it was vital to ensure that sufficient resources were made available to the GB regulated businesses, with one respondent suggesting that undertakings should be required from NGT to that effect. Concerns focused around the extent to which funds released as a result of the merger would be used for overseas expansion and the extent to which key GB personnel would be involved in such overseas operations. One of the respondents took the view that the merger would not raise any additional risks in that respect and that staff released by the merger of the two network businesses might usefully be employed on overseas operations.

4.18 National Grid and Lattice took the view that there was no need for concerns regarding a loss of managerial focus as, following the merger, the GB regulated businesses would account for a large proportion of NGT's revenues and would have a significant role to play in securing the group's reputation. As such they would not seek to do anything that would jeopardise the operation of the GB regulated businesses. In addition, they took the view that the increasing focus on network performance in price controls meant that suitable resources would need to be focused on the GB regulated businesses.

*Ofgem's views*

4.19 Ofgem has considered the view expressed by some respondents that the UK regulated businesses might suffer if the attention of management was increasingly focused on international expansion rather than the operation of NGC and Transco. The two network businesses will continue to require

considerable focus from NGT's management and Ofgem would be concerned if key personnel were being increasingly employed on overseas activities at the expense of the GB regulated businesses.

4.20 However, Ofgem does not consider that it is necessary to introduce specific obligations on NGC and Transco in order to secure that sufficient management resource is devoted to the GB regulated businesses. Ofgem recognises the importance of the GB regulated businesses to NGT both in terms of the revenue that they generate and in terms of reputation. Ofgem believes that there will be sufficient incentives (particularly given Ofgem's increased focus on incentive based price regulation) on NGT to run the GB regulated businesses effectively. In addition, Ofgem considers that the regulatory framework for NGC and Transco in its present form is sufficient. The framework includes various mechanisms to incentivise NGT, including specific quality and security standards and general legislative and licence obligations, failure to adhere to which might result in a financial penalty.

4.21 It will, of course, remain open to Ofgem to seek a modification in the future if changing circumstances indicate that this would be appropriate.

#### **Ofgem's proposals**

4.22 In view of the above Ofgem does not intend at this stage to place any additional obligations on NGC or Transco with respect to the managerial resources of the GB regulated businesses.

## 5. Synchronisation of regulatory work programmes

### *May 2002 consultation*

- 5.1 In its May 2002 consultation paper Ofgem identified three areas where the merger of National Grid and Lattice might be considered to have an impact on Ofgem's existing work programme:
- ◆ the setting of transmission operator (TO) price controls/quality of supply issues;
  - ◆ the setting of SO price controls, including SO incentives, in both gas and electricity; and
  - ◆ the potential disposal of, and future regulatory regime for, Transco's LNG facilities.
- 5.2 Ofgem sought views as to whether, in the light of the merger, there was anything that suggested that the timing or content of these existing work programmes should be altered.

### *TO price controls/quality of supply issues*

#### **Discussion**

- 5.3 Both NGC and Transco are subject to price controls which are set by Ofgem on a five yearly basis. The existing NGC TO price control began in April 2001 and will run until 31 March 2006. Proposed licence modifications relating to Transco's price control were published on 12 April 2002, for a TO price control for Transco which would run from 1 April 2002 to 31 March 2007<sup>17</sup>.
- 5.4 As stated in Ofgem's final proposals on Transco's price control from 2002<sup>18</sup>, Ofgem will over the next eighteen months be taking forward work on the introduction of separate price controls for each of the LDZs. Ofgem intends to publish an initial consultation on LDZ price controls in July 2002. Separate LDZ controls could be introduced from April 2004.

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<sup>17</sup> See paragraphs 1.9 and 1.10.

<sup>18</sup> 'Review of Transco's price control from 2002 – final proposals' Ofgem September 2001.

- 5.5 Ofgem sought views as to whether, in the light of the merger, there was anything that suggested that the timing or content of this work should be altered.

*Respondents' views*

- 5.6 Several respondents commented that the TO price controls for both companies should be reopened straight away in order to ensure that the efficiency savings that will result from the proposed merger are passed back to customers.
- 5.7 Respondents generally supported the future alignment of the timing of the two TO price controls.
- 5.8 One respondent commented that Ofgem's planned work on the introduction of separate price controls for the LDZs should be deferred until further details are available about the future structure of Transco (and NGT).

*Ofgem's views*

- 5.9 Having considered the responses received to the May 2002 consultation paper Ofgem does not consider that it is necessary to alter the scope or timing of its present work on the TO price controls for NGC and Transco. Efficiency savings that result from the merger will be considered and passed back to customers at the time of the next periodic review, along with general efficiency savings, rather than by reopening the existing price controls.
- 5.10 In relation to the timing of future TO price controls Ofgem considers that there may be some merit in seeking alignment and would welcome further views on this. However, it is not Ofgem's intention to reopen either of the TO price controls before the respective five year periods, for which each was set, ends. If it is considered appropriate to align the TO price controls going forward this could be done by setting them for different periods of time, such that the succeeding price control periods are co-terminous.
- 5.11 Ofgem is in the process of consulting on separate price controls for each of the LDZs. Separate price controls could be introduced from April 2004. Ofgem does not consider that any changes in the corporate structure or organisation of NGT that may take place following the completion of the transaction will have

any material impact on LDZ price controls. As such, Ofgem does not consider that it is necessary to defer its planned work in this area.

### **Ofgem's proposals**

- 5.12 Ofgem does not intend as a result of the merger to open the TO price controls before they end in 2006 for NGC and 2007 for Transco or to alter the timing or content of Ofgem's present work on the introduction of separate price controls for the LDZs.
- 5.13 Ofgem would welcome further views on whether there is any benefit in seeking, at a later date, to align the timing of the TO price controls for NGC and Transco.

### ***System operator price controls and incentives***

#### **Discussion**

- 5.14 In March 2001, Ofgem introduced a series of incentives for NGC in relation to the internal and external costs incurred in its role as SO. The internal costs include the costs of its control centre, systems and staff. The external costs cover the costs of procuring and using balancing services. The internal cost aspect of the existing incentive scheme is due to expire on 31 March 2006 while the external cost aspect was due to expire on 31 March 2002. The external SO incentive scheme has been reviewed and substantially rolled-over to cover the period to 31 March 2003, from which point Ofgem intends to introduce a new 'deep' SO incentive scheme<sup>19</sup>.
- 5.15 Similar incentives in relation to the operation of the gas transmission system for Transco were proposed by Ofgem on 12 April 2002<sup>20</sup>.
- 5.16 The Transco day-to-day SO incentive schemes seek to incentivise Transco to carry out a number of NTS SO functions efficiently, through rewards for over-performance and penalties for under performance against a series of targets. These incentives cover residual gas balancing, system balancing (shrinkage and system storage), entry capacity constraint management and the SO's (internal)

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<sup>19</sup> 'NGC system operator incentive scheme from April 2002: final proposals': Ofgem February 2002.

<sup>20</sup> See paragraphs 1.9 and 1.10.

operating and capital costs. In general, these incentives will operate for two years, at which point elements of the incentives will be reviewed.

- 5.17 In addition to these proposed SO incentives, Ofgem has sought to improve the incentives on Transco to meet changes in the demand for network capacity in a timely and efficient manner. At entry, they provide Transco with the opportunity to earn additional returns, above its regulated cost of capital, where it delivers firm capacity rights greater than an agreed baseline level. Under the proposed incentive scheme Transco would be able to earn incentive revenues for a rolling five year period from the date when the additional capacity is delivered. Ofgem has proposed that the parameters of Transco's entry capacity investment incentive be reviewed as part of Transco's periodic price control review from April 2007.
- 5.18 At exit, the proposed incentives are designed to encourage Transco to consider alternatives to pipeline investment (such as the use of interruptible contracts and local storage), where it is more efficient to do so.
- 5.19 Ofgem's aim is to introduce a revised SO incentive scheme for NGC consistent (where appropriate) with developments in relation to Transco's proposed SO incentive scheme<sup>21</sup>. This work is being taken forward with a view to the introduction of an enhanced SO incentive scheme for NGC in April 2003 and Ofgem intends to consult in the coming months on the form, scope and duration of an appropriate 'deeper' SO incentive scheme to apply from April 2003.

#### *Respondents' views*

- 5.20 Virtually all respondents raised some concerns regarding the increased information that would be available to NGC and Transco following the merger. In particular concerns focused on the increased accessibility of information in relation to NGC and Transco's respective SO functions. A number of respondents commented that it was important to review NGC and Transco's respective SO incentive schemes as soon as possible to ensure that they did not operate to the disadvantage of others and to ensure that they did not encourage NGC to discriminate between the two network businesses in any way.

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<sup>21</sup> 'Transco's price controls and the NTS SO incentives 2002-07: explanatory notes to accompany the section 23 notice of proposed changes to Transco's gas transporter licence' Ofgem April 2002.



### *Ofgem's views*

- 5.21 Ofgem has considered the concerns that were raised by respondents in relation to the increased accessibility of information following the merger (which are discussed in Chapter 2) and its potential effect on the operation of and interaction between the SO incentive schemes. Ofgem does not believe that the timing of its planned work on SO price controls/incentives should be altered as a result of the merger.
- 5.22 However, in view of the merger and respondents' concerns regarding the interaction of the SO incentives faced by NGC and Transco, Ofgem will be expanding its planned work on SO price controls and incentives to consider the operation of and the interaction between the two sets of SO price controls and incentives within NGT.

### **Ofgem's proposals**

- 5.23 Ofgem does not intend to alter the timing of its planned work on SO price controls and incentives but will be expanding its work to consider the operation of and interaction between the two SO's price controls and incentives as a result of the merger.

### **LNG**

#### **Discussion**

- 5.24 Transco currently owns and operates five LNG storage facilities. These facilities are connected to Transco's NTS and are capable, in aggregate, of providing 812 GWh of gas a day. Services offered by these storage facilities are sold to gas shippers and to Transco. Shippers use LNG storage to meet customer demand at peak times. Transco uses LNG storage to help operate the system and as a substitute for pipeline capacity.
- 5.25 Lattice has recently proposed to transfer ownership of its LNG storage facilities from Transco into Lattice. An effect of this move would be to move LNG outside of the regulated business. Ofgem initially welcomed this proposal, as this separation of the LNG facilities may help to ensure that all users of LNG facilities can obtain capacity on a non-discriminatory basis.

- 5.26 Ofgem is considering, in taking account of Lattice's proposals, what, if any, form of regulation is necessary in the future for the LNG facilities. In taking this forward Ofgem will also need to identify any implications that a particular form of regulation may have on Transco's purchase (as SO) of LNG.

*Respondents' views*

- 5.27 One respondent commented on LNG issues. The comments raised will be taken forward as part of Ofgem's planned work on LNG.

*Ofgem's views*

- 5.28 Ofgem does not consider that it is necessary to alter the content or scope of its existing work on LNG and intends to publish a consultation paper on the issues associated with Transco's ownership of LNG within the next week.

**Ofgem's proposals**

- 5.29 Ofgem does not intend to take forward any issues relating to LNG as part of this consultation process. Ofgem will be publishing a separate paper on LNG within the next week.

## 6. Views and next steps

### *Views*

6.1 Ofgem would welcome views on:

- ◆ the regulatory issues identified by Ofgem in Chapters 2, 3, 4 and 5 and Annex C and, where applicable, Ofgem's proposed regulatory solutions; and
- ◆ any other regulatory issues arising from the merger.

6.2 Comments are requested by Wednesday 28 August 2002 to:

Lisa Vango  
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9 Millbank  
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SW1P 3GE  
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### *Next steps*

6.3 Subject to this consultation, Ofgem intends to bring forward proposals to modify NGC's electricity transmission licence (under section 11 of the Electricity Act) and Transco's gas transporter licence (under section 23 of the Gas Act) to effect the changes outlined in this paper, with a view to having the modifications in place during autumn 2002.

## **Annex A List of respondents to May 2002 consultation**

Non-confidential responses to Ofgem's May 2002 consultation paper 'Proposed merger of National Grid Group plc and Lattice Group plc to create NGT plc' were received from:

Association of Electricity Producers

British Energy

British Gas Trading

Chemical Industries Association

The Confederation of UK Coal Producers

Cornwall Consulting

Corus

Dynegy

Energywatch

Innogy

London Electricity Group

National Grid Group /Lattice

Powergen

TXU Europe

## Annex B Draft licence condition on EnMo Limited

Ofgem proposes that the following draft licence condition is inserted into the electricity transmission licence of NGC and the gas transporter licence of Transco.

### Draft Special Condition [ ]: Restriction on Use of Information deriving from the EnMo Business

- 1 The licensee shall procure that each ultimate holding company of the licensee which is also an ultimate holding company of EnMo or such other corporate body as the Authority may from time to time designate as such (“a relevant ultimate holding company”) shall give an undertaking in the form described in paragraph 5.
- 2 Without prejudice to the licensee’s obligation under paragraph 1, any breach of the undertaking given pursuant to paragraph 1 shall be a breach by the licensee of the licence.
- 3 Any information, held directly or indirectly, by EnMo or any subsidiary or holding company of EnMo, or by any employee, agent, adviser, consultant, contractor, director or officer of EnMo or any subsidiary or holding company of EnMo, relating to volumes or prices of gas, electricity and related products or services, traded or to be traded in the course of the EnMo business or to any of the parties to any such trade in relation thereto shall be treated as confidential information (“EnMo confidential information”).
- 4 Notwithstanding paragraph 3, the following information shall not fall within the definition of EnMo confidential information for the purpose of this special condition :-
  - (i) information which is in the public domain, other than through breach of paragraph 1; or
  - (ii) information solely relating to the licensee’s trades through the EnMo business (to the extent the same is properly disclosed to the licensee in the ordinary course of the EnMo business in compliance with all applicable laws, regulations and contracts).
- 5 The licensee shall procure from each relevant ultimate holding company a legally enforceable undertaking in favour of the licensee that that relevant ultimate holding company shall ensure that no EnMo confidential information shall be disclosed to or otherwise howsoever come into the possession of the licensee whether directly or indirectly. Such undertaking shall be obtained from each relevant ultimate holding company within seven (7) days of that company becoming a relevant ultimate holding company and shall remain in force for so long as it remains a relevant ultimate holding company.
- 6 The licensee shall:
  - (a) deliver to the Authority evidence (including a copy of the undertaking) that the licensee has complied with the obligation to procure the undertaking pursuant to this special condition;
  - (b) inform the Authority immediately in writing if the directors of the licensee become aware that the any such undertaking has ceased to be legally enforceable or that its terms have been breached or that there has been a change in control or identity of a relevant ultimate holding company; and

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(c) comply with any direction from the Authority to enforce any such undertaking.

7. In the event that any EnMo confidential information comes into the possession whether directly or indirectly of the licensee, the licensee shall ensure that such information shall be treated as confidential, and shall not be used in any respect for the purpose of or in connection with the management or operation of its transportation business or transmission business.

8. In this special condition:

- “EnMo” means EnMo Limited, a company incorporated in England and Wales under the Companies Act 1985 (registered number 3751681) and having its registered office at 15 Marylebone Road, London, NW1 5JD.
- “EnMo business” means any business carried on by EnMo including, without limitation, the operation of the On-the-Day Commodity Market in gas operated by EnMo.
- “information” shall include, without limitation, any documents, accounts, estimates, returns, records or reports and data in written, verbal or electronic format and information in any form or medium whatsoever.
- “transmission business” means the authorised business of the licensee or any affiliate or related undertaking in the planning, development, construction, maintenance and commercial management of the licensee’s transmission system (whether or not pursuant to directions of the Secretary of State made under section 34 or 35 of the Act) and the operation of such system for the transmission of electricity, including the transmission owner activity, the balancing services activity and any business in providing connections to the licensee’s transmission system; but shall not include
- (i) any other separate business;
  - (ii) any business of the licensee or any affiliate or related undertaking in the provision of settlement services in connection with the BSC or the Pooling and Settlement Agreement; or
  - (iii) any other business (not being a separate business) of the licensee or any affiliate or related undertaking in the provision of services to or on behalf of any one or more persons.

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| "transportation business"  | means the activities of the licensee connected with the development, administration, maintenance and operation of its pipe-line system.  |
| "ultimate holding company" | shall mean any company or body corporate which is a holding company and is not itself a subsidiary of another company or body corporate. |

## Annex C Financial ringfencing provisions

The financial ringfence is set out in a series of licence conditions which are set out in the table below<sup>22</sup>.

|  | <b>SLCs for Electricity Distribution</b> | <b>NGC</b>             | <b>Trancso</b>                         |
|--|--|------------------------|--|
| Provision of information to the Authority          | SLC 24                                   | Special condition AA11 | Amended SLC 24                         |
| Disposal of relevant assets                        | SLC 29                                   | SLC 10                 | Amended SLC 29                         |
| Prohibition of cross-subsidies                     | SLC 41                                   | SLC 12                 | SLC 41                                 |
| Restriction on activity and financial ring fencing | SLC 43                                   | Special condition AA6  | Special condition 2                    |
| Availability of resources                          | SLC 44                                   | Special condition AA7  | Special condition 3                    |
| Undertaking from ultimate controller               | SLC 45                                   | Special condition AA8  | Amended SLC 45                         |
| Credit Rating of licensee                          | SLC 45                                   | Special condition AA9  | Special condition 4                    |
| Indebtedness                                       | SLC 47                                   | Special condition AA10 | Amended SLC 47 and Special condition 5 |

<sup>22</sup> Licence obligations relating to regulatory accounts and the change of financial year are generally considered to be part of the financial ringfence, but have not been included in the above table and are not addressed in this consultation paper. Ofgem is currently taking forward separate work on regulatory accounts in general and any issues that may need to be addressed as a result of the merger will be addressed as part of that work.