



Shippers, Transco, potential DN purchasers and other interested parties

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Dear Colleague,

Timetable for Potential Gas Distribution Network Sales Project

Ofgem has been asked to provide further information regarding the timetable for Transco's proposed sale of one or more of its gas distribution networks (DNs) so that industry participants are able to plan their resources effectively.

In response to these concerns, Ofgem considers that it would be helpful to set out the process it intends to adopt in the coming months with respect to considering the proposed sale of DN. This process includes the development of a final Regulatory Impact Assessment (RIA) on potential DN sales as well as the steps that would need to be taken to develop a licensing regime that would support the sale of one or more distribution businesses. In this letter we set out these processes and also provide an indicative timetable for their completion. The indicative timetable is attached to this letter.

In setting out this timetable and process, it is important to note that as the DN Sales are not an Ofgem lead project but a commercial transaction by National Grid Transco (NGT) that requires regulatory approval. As such, several elements of the timetable are necessarily dependent upon the commercial decisions of NGT.

In addition, in issuing this indicative timetable and describing the regulatory processes, it is important to make clear that there can be no expectation on the part of Shippers, Transco, potential DN purchasers or any other interested parties either as to what the Authority's final decision in relation to the proposed DN sales may be, or as to the regulatory framework which may be implemented if the Authority consents to the proposal. The information and guidance in this letter and attachment is provided on an informal basis and should not be treated as binding on the Authority. Nothing in this letter or the attachment is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion in this matter will not be fettered by any statements made in this letter or the attachment.

Regulatory Impact Assessment

A key element of the process going forward and the indicative timetable is the release of the final RIA on the proposed sales and the Authority's decision on whether or not to consent to the disposal of DN assets.

Under the proposed process, Ofgem intends to release the final RIA in late September 2004. The Authority would subsequently consider whether to consent to a disposal of the DN assets at its November 2004 meeting.

If the Authority decides to give consent, it is likely that it would seek to impose a requirement on Transco that disposal of shares in any of the DN companies should be subject to the Authority's consent and to certain other conditions being met. Ofgem is still considering the nature of any conditions that the Authority may wish to impose and which would need to be met before consenting to a share sale. Such conditions however are likely to include a requirement that the Authority be satisfied as to the financing structures to be adopted by any new owner of a DN company.

Proposed approach to establishing new licence structure

A key determinant of the indicative timetable is the mechanism by which the DNs receive Gas Transporter (GT) licences. Under the process proposed, NGT would apply to Ofgem for new additional GT licences for the DNs to be granted to Transco to accommodate a potential sale. Ofgem would then consult for a period of two months on the grant of these licences under the Gas Act 1986. Subject to consideration of consultation responses, the new additional GT licences would then be granted to Transco. It is anticipated that the new licences would, at this stage, mirror Transco's existing GT licence.

At the same time, the development of the new licences would commence and proposed changes to the DN licences and Transco's existing licence would be the subject of an informal consultation document that Ofgem intends to release in early September.

This consultation document will have been informed by the development of the commercial and regulatory framework that has been undertaken through the workgroup process in recent months. As has been noted in recent workgroup meetings, Ofgem is working towards reaching all significant decisions on the development of the commercial and regulatory framework by early August 2004.

Following the release of the informal consultation document and having considered respondents' views, Ofgem would issue a notice under section 23 of the Gas Act to formally modify each of Transco's GT licences (ie Transco's existing licence and the new DN licences). The notice would be formally consulted upon for 28 days.

As noted above, during the formal section 23 consultation period the Authority will meet to determine whether it wishes to consent to the disposal by Transco of DN assets to DN companies that are wholly owned by Transco under Amended Standard Condition 29 of Transco's GT licence. This meeting is scheduled to occur in late November.

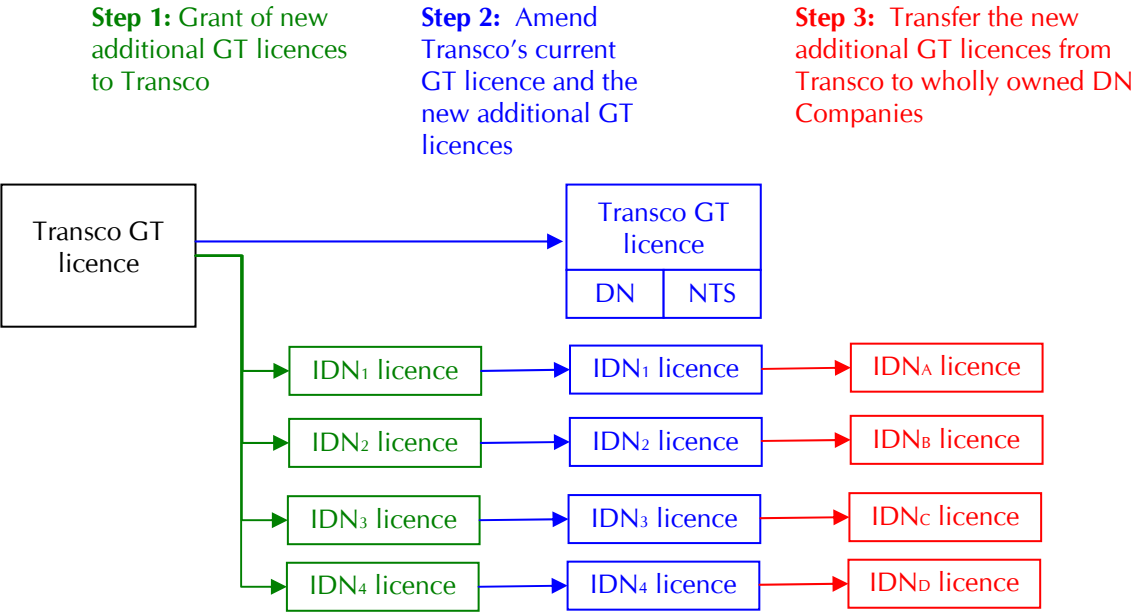
In the event that the Authority consents to a sale then, following expiry of the formal section 23 consultation period and subject to consideration of responses, the Authority would issue

directions to bring into effect the modifications to Transco’s existing licence and the new DN licences.

Following the completion of this process, Transco would then apply for the new DN licences to be transferred to the DN companies that are wholly owned by Transco. Once this application is received there would be a two month formal consultation under the Gas Act relating to the transfer. Ofgem expects that this application would be received in December 2004 thereby allowing the consultation and subsequent transfer to be completed by 1 March 2005 subject to the responses received to the consultation process.

The process outlined above is depicted in Figure 1 below. It should be noted if the Authority forms the view that each of Transco’s retained DN and NTS businesses should be separate legal entities, then it will also be necessary to grant, amend and transfer one or more additional licences to accommodate the separate Transco retained DN businesses.

Figure 1 Multiple grant and transfer mechanism (assuming no legal separation)



Ofgem considers that the indicative timetable provides industry participants with sufficient time to input into the development of a regime which would support the proposed sale of one or more DNs. It features both informal and formal consultation on proposed changes to Transco’s current GT Licence and the new additional DN GT licences, as well as a subsequent consultation on transferring licences to the new wholly owned Transco subsidiary DN companies.

HSE approvals and completion

Once the process described above has been completed, NGT would then proceed towards obtaining the necessary HSE approvals for the safety case of each DN company. Upon obtaining these approvals, NGT would then be in a position to proceed towards completing the

sale. The timetable associated with obtaining HSE approvals and completion is not the subject of this letter as it is a process that will be managed by NGT.

Network Code timetable

Transco is currently developing an indicative timetable for the resolution of issues associated with the changes to the Network Code and the development of the offtake arrangements. Ofgem anticipates that these issues will be resolved by late February 2005.

Key risks

Whilst this indicative timetable is challenging, we consider that it is feasible, subject to the following risks:

- ◆ The risk that significant policy or legal issues, of which we are not yet fully aware, may manifest themselves which, in Ofgem's opinion, require resolution before the project can proceed. This includes the risk of significant unforeseen issues arising from responses to the consultations which we are required to undertake. Given that this project represents the biggest change to the gas industry for a number of years, we consider the risk of new policy and legal issues arising to be high; and
- ◆ The risk that Ofgem would need to reconsider the allocation of roles and responsibilities between the NTS and the DNs in the event that we are unable to develop satisfactory commercial arrangements at the NTS/DN interface that provide for efficient investment, efficient operation and security of supply.

The above risks are not intended to be exhaustive and it is possible that the indicative timetable may slip due to other unforeseen eventualities.

Ofgem intends to discuss the indicative timetable at the Development & Implementation Steering Group meeting on 20 July. Anyone who wishes to join Ofgem's DN sales workgroups, or who wishes to attend a particular meeting, should contact Tracey Hunt on 0207-901-7356.

If you have any questions regarding this letter please do not hesitate to contact me on the above number. Jessica Hunt on extension 7431 will also be pleased to help.

Yours sincerely

Mark Feather
Head of DN Sales

Attachment 1 DN Sales project indicative timetable

Timetable post Authority meeting contingent upon Authority decision

