

Legal separation between Transco's NTS and RDN businesses

Development & Implementation Steering Group
16 November 2004

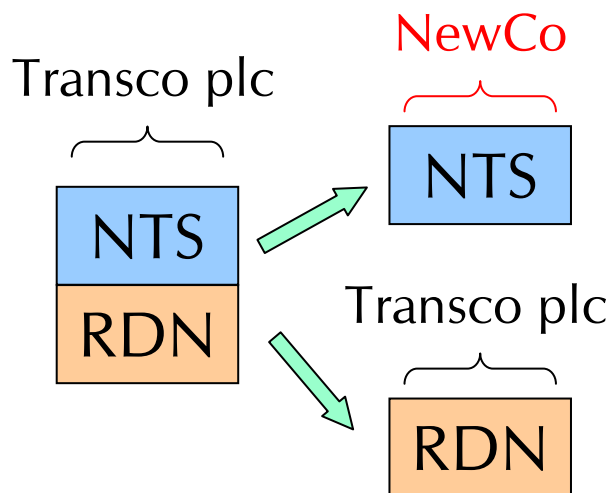
August 2004 Authority decision

Authority 'minded to' require legal separation as well as targeted structural separation

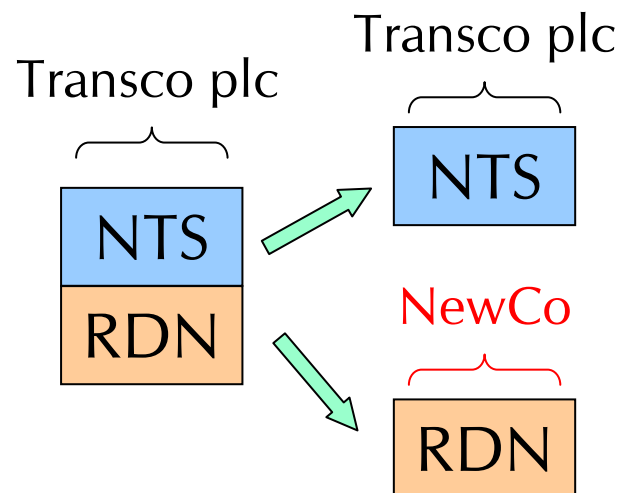
- 'Minded to' decision required as a number of detailed implementation issues needed to be resolved
- Since August, Ofgem has been working on these issues
 - a number of potential problems have been identified
- Necessary for the Authority to reconsider legal separation...

How to achieve legal separation

Option 1 – NTS hive down



Option 2 – RDN hive down



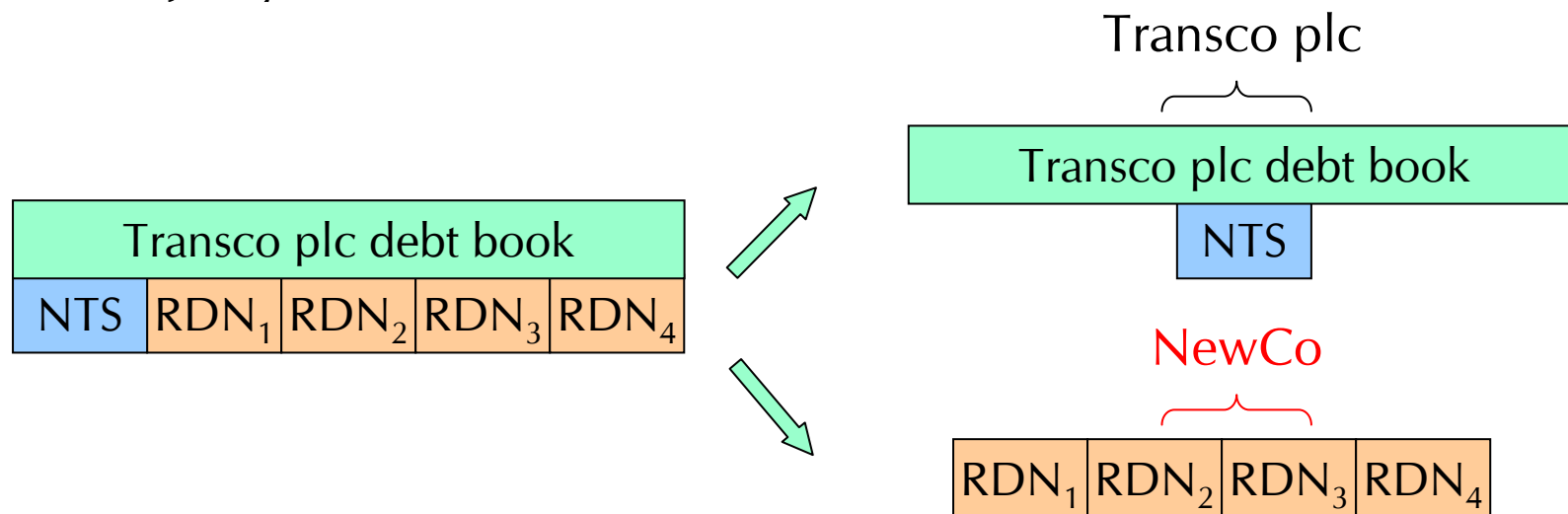
- In principle, Ofgem is indifferent between two options (provided that the interests of customers are protected)
 - need to consider risks and unintended consequences

Option 1 – NTS hive down

- Key objective of Ofgem is to ensure continuity of arrangements, particularly for gas balancing
 - failure to do so could harm competition in the wholesale gas market with associated costs to customers
- Continuity needs to be considered in terms of both existing Network Code arrangements and third party contracts
- Having carefully examined issue, Ofgem identified a low probability – high cost outcome which resulted in Ofgem having a preference towards RDN hive down.

Option 2 – RDN hive down

- If RDN business is hived down from Transco plc, Transco could incur significant costs associated with debt restructuring
 - Majority of assets lie with RDN business



No legal separation

- Given these implementation problems, costs of legal separation could potentially be higher than benefits
- Authority has considered this further information, and has decided that legal separation should not be required
- Instead, a set of licence conditions that emulate the benefits of legal separation will be developed
 - Proportionate response to the risk of undue discrimination between RDNs and IDNs

Potential new licence conditions

Benefit of legal separation

Potential new licence condition to emulate benefit

**Level playing field
for comparative
regulation**



Regulatory accounts to be in form of statutory accounts

Undertaking from parent company

**Robust approach to
corporate
governance**



NTS & RDN businesses to conduct business as if substantially their only business

NTS & RDN businesses to conduct business as if stand alone companies listed on London Stock Exchange

Ofgem is also considering provisions relating to independent directors

Governance provisions
modelled on water industry



Costs of no legal separation

- Not all benefits of legal separation can be retained
 - difficult choice for Authority

Consistency



Legal separation between transmission and distribution exists in electricity (albeit not an Ofgem requirement)

Reduced complexity



Alternative arrangements arguably more complex

Way forward

- Authority position set out in Final IA
- Licence conditions to emulate business separation developed through
 - DISG discussions
 - Consultation on restructuring of Transco's licence



Promoting choice and value for all
gas and electricity customers