

NOTICE UNDER SECTION 23(3) OF THE GAS ACT 1986

This Notice is issued by the Gas and Electricity Markets Authority (the "**Authority**") under section 23(3) of the Gas Act 1986 (the "**Act**") in connection with National Grid Transco plc's ("**NGT**") proposed sale of one or more of Transco plc's ("**Transco**") local gas distribution networks ("**DNs**") (the "**Proposed Transaction**").

Background

1. Transco (a company registered in England & Wales with company number 2006000) is the holder of a gas transporters ("**GT**") licence treated as granted under section 7 of the Act which was amended and restated by a licensing scheme made by the Secretary of State for Trade and Industry (the "**Secretary of State**") pursuant to Paragraph 19 of Schedule 7 to the Utilities Act 2000 on 28 September 2001 (the "**Original Transco Licence**").
2. On 22 July 2004, the Authority issued a notice under sections 7(5) and 8(4) of the Act stating that Transco had (in connection with the Proposed Transaction) applied for eight additional GT licences which the Authority was minded to grant on the basis that any surplus licences could be revoked.
3. Pursuant to section 7 of the Act, on 5 November 2004, the Authority (without in any way fettering its discretion in relation to the Proposed Transaction) granted five additional GT licences to Transco (the "**Additional Transco Licences**") rather than the eight originally applied for by Transco¹ and Transco formally withdrew its remaining three applications. As a result of this, as at the date of this Notice, Transco holds in total six GT licences. The five Additional Transco Licences were granted in substantially the same form as the Original Transco Licence and a copy of the form in which the Additional Transco Licences were granted can be found on Ofgem's website².

¹ This reflects the Authority's decision in November 2004 not to require each of the DNs which are to be retained by NGT (the "**RDNs**") to be held in separate legal entities

² [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9161_A copy of the GT Licences issued to Transco 05.11.04.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9161_A%20copy%20of%20the%20GT%20Licences%20issued%20to%20Transco%2005.11.04.pdf)

4. The Original Transco Licence and the five Additional Transco Licences are together referred to in this Notice as the **"Transco Licences"**.
5. Until 1 February 2005 all gas transportation assets owned by Transco were operated pursuant to the Original Transco Licence. Until 1 February 2005, the five Additional Transco Licences whilst active, did not relate to any particular gas transportation assets owned or operated by Transco.

The Modification process to date: November 2004 section 23 Notice

6. As part of the Proposed Transaction, pursuant to section 23(3) of the Act, on 25 November 2004 the Authority published a notice proposing modifications to each of the Transco Licences³ (the **"Initial S.23 Notice"**) together with an explanatory document⁴.
7. The Initial S.23 Notice sought to consult on the Authority's proposal (as part of the Proposed Transaction) to separate the price controls (as set out in the Original Transco Licence) to achieve revenue separation between Transco's National Transmission System (the **"NTS"**) and each of the DN's which are proposed to be disposed of by Transco (the **"IDNs"**) and each of those DN's which are proposed to be retained by Transco (the **"RDNs"**). The Initial S.23 Notice stated that the effect of the proposed modifications would be that each of the five Additional Transco Licences would relate to specific DN assets and the Original Transco Licence would relate to the NTS assets only.
8. As part of the Proposed Transaction, Transco is proposing to hive-down the four IDNs (the South DN, the North DN, the Wales and West DN and the Scotland DN) to four wholly owned Transco subsidiary companies respectively (Blackwater G Limited, Blackwater F Limited, Blackwater 2 Limited and Blackwater SC A Limited). In addition, Transco is proposing to transfer four of the five Additional Transco Licences to each of the four wholly owned subsidiary companies. After hive-down of the four IDNs and transfer of the four relevant licences, Transco proposes to sell the shares in each of the four relevant wholly owned subsidiary companies to third party purchasers.

³ http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=,1_8936#top8936

⁴ National Grid Transco – Potential sale of gas distribution network businesses. Licensing: Next Steps. Formal consultation under Section 23 and informal consultation under Section 8AA of the Gas Act 1986 November 2004 263/04

9. The proposed hive-down by Transco of the four relevant IDNs from Transco to the four relevant wholly owned subsidiary companies will require, inter alia, the consent of the Authority pursuant to Amended Standard Condition 29 of the Original Transco Licence. It was made clear in the Initial S.23 Notice and the accompanying explanatory document that the modifications proposed in the Initial S.23 Notice would only be directed by the Authority if the Authority granted its consent to Transco to hive-down the four relevant IDNs under Amended Standard Condition 29 of the Original Transco Licence.
10. On 12 January 2005, the Authority received four applications from Transco seeking the Authority's consent under Amended Standard Condition 29 of the Original Transco Licence to dispose of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies as part of the Proposed Transaction.
11. On 20 January 2005, the Authority met to consider Transco's applications. After careful consideration the Authority granted its consents to Transco under Amended Standard Condition 29 of the Original Transco Licence to dispose of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies. Such disposal is not to take place prior to 1 May 2005. The Authority's consents were granted on a conditional basis. Transco is required to satisfy a number of conditions precedent before the consents become effective. In addition, the Authority attached a number of conditions subsequent to its consents. In particular (and without limitation) the Authority's further consent is required in relation to a number of areas of the Proposed Transaction. Without limitation, as a condition to the Authority's consent, Transco is prohibited from selling the shares in the four relevant wholly owned subsidiary companies without the prior consent of the Authority.
12. It is noted that the proposed hive-down of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies also requires the consent of the Secretary of State under Amended Standard Condition 29 of the Original Transco Licence. The Secretary of State granted this consent on 27 January 2005.
13. On 1 February 2005, in accordance with the powers contained in section 23 of the Act and with the written consent of Transco in respect of each of the six Transco Licences, the Authority issued a direction modifying the licence

conditions in each of the six Transco Licences in the manner largely specified in the Initial S.23 Notice respectively with effect from 1 February 2005⁵. As a result, as at the date of this Notice, there is revenue separation between the NTS and each of the four IDNs which are proposed to be disposed of by Transco and each of the four RDNs which are proposed to be retained by Transco. As at the date of this Notice, the four relevant Additional Transco Licences respectively relate only to each of the four IDNs to be disposed of by Transco, one of the Additional Transco Licences relates only to the four RDNs to be retained by Transco (referred to in this Notice as the “**RDN Additional Transco Licence**”) and the Original Transco Licence relates to only the NTS. This Notice relates to the Original Transco Licence and the RDN Additional Transco Licence only.

14. In order to make the modifications set out in this Notice to the Original Transco Licence and the RDN Additional Transco Licence, Transco’s consent will be required in accordance with the requirements of section 23(6) of the Act as it will be the holder of these two licences at the relevant time. This means that only Transco will be asked to provide consent to the proposed modifications. This consent, if provided by Transco, would enable the Authority, but not oblige it, to direct that the modifications be made.
15. However, in light of the Proposed Transaction, Ofgem would particularly hope to receive comments on the proposed modifications to the Original Transco Licence and the RDN Additional Transco Licence from, amongst others, potential DN purchasers and other interested parties.
16. In issuing this Notice it is important to make clear that after the Authority’s decision in relation to the Proposed Transaction on 20 January 2005, there can be no expectation on the part of NGT, Transco, potential shippers, suppliers, DN purchasers or any other interested parties as to any further decisions which the Authority may be required to take or any further consents which the Authority may be required to grant (including for the avoidance of doubt any decisions or consents which may be necessary pursuant to a condition precedent or a condition subsequent attached to the consents granted by the Authority on 20 January 2005) in relation to the Proposed Transaction.

⁵ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043_2405.pdf

17. The information in this Notice is not binding on the Authority. Nothing in this Notice is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion will not be fettered by any statements made in this Notice.

The Authority hereby gives notice pursuant to section 23(3) of the Act as follows:-

Proposed modifications

18. The Authority proposes, as part of the Proposed Transaction, to modify the conditions of the Original Transco Licence and the RDN Additional Transco Licence as set out in this Notice, the Annexes and the explanatory document (including its appendices) which accompanies this Notice. The proposed modifications are discussed and explained in the explanatory document which accompanies this Notice⁶.

19. A mapping table can be found in Appendix 4 to the explanatory document which accompanies this Notice. This table details in respect of each condition in Transco's licences, the modifications proposed. In summary, the table:

- a. maps the current conditions in the Transco Licences to the final version of the licence as proposed in this Notice. By way of example, and without limitation, Amended Standard Condition 17 (ASC17): Provision of services for persons who are of pensionable age or disabled or chronically sick: arrangements in respect of meters, of the Transco Licences is to be modified by proposing in substitution for ASC 17 a new standard special condition applicable to both the NTS and DN GTs as Standard Special Condition A19. The equivalent standard condition is shown on the table as switched off. Following introduction of the new condition, ASC 17 would be removed from all of Transco's licences;
- b. shows any new conditions which are proposed to be introduced and the nature of the condition (i.e. whether it is proposed as a standard special condition or special condition). By way of example, and without limitation, Standard Special Condition A12: Joint Office Governance

⁶ National Grid Transco – Potential sale of gas distribution network businesses. Formal consultation under Section 23 and Section 8AA of the Gas Act 1986 February 2005

Arrangements which is proposed as a Standard Special Condition applicable to both the NTS and DN- GTs ; and

- c. shows any condition which is proposed to be switched off or removed from the Transco Licences. By way of example, and without limitation, Standard Condition 4C: Charging of Gas Shippers – Supplemental Connection charges is proposed to be removed from all of Transco’s licences as it is time redundant.

The nature and effect of the changes set out in the mapping table are proposed in Chapters 4 and 5 of the explanatory document.

Reasons for proposed modifications

- 20. The reasons why the Authority is proposing to make these modifications to the Original Transco Licence and the RDN Additional Transco Licence and their effects are set out in the documents listed in Annex 1 to this Notice.

Summary of the effect of proposed modification

- 21. In summary, the effect of the proposed licence modifications is to restructure each of the Original Transco Licence and the RDN Additional Transco Licence to support a divested industry structure with the intention of protecting the interests of customers in the event that Transco sells one or more of its IDNs. The proposed modifications and their effects are discussed and explained in the explanatory document which accompanies this Notice⁷.
- 22. These modifications, if made, would take effect on such date as the Authority may specify in writing.

Documents

- 23. Copies of the proposed licence modifications are attached to this Notice, the explanatory document that accompanies this Notice and other documents referred to in this Notice are available (free of charge) from the Ofgem Research and Information Centre (Tele: 0207 901 7003) or on the Ofgem website at www.ofgem.gov.uk

⁷ National Grid Transco – Potential sale of gas distribution network businesses. Formal consultation under Section 23 and Section 8AA of the Gas Act 1986 February 2005

Additional information – parallel section 8AA notice

24. Respondents should note that the Authority, pursuant to section 8AA(9) of the Act, has today also published a separate but related document giving notice (in connection with the Proposed Transaction) that it proposes to grant consent to Transco to the transfer (subject to certain modification conditions) of the four relevant Additional Transco Licences relating to each of the four IDNs to be disposed of by Transco which are proposed to be transferred from Transco to each of the four relevant wholly owned Transco subsidiary companies⁸.
25. Section 8AA(4) of the Act provides that the Authority's consent to a transfer of a licence may be given subject to compliance with such modifications or other conditions as the Authority considers necessary or expedient. The Authority may grant its consent subject to a modification condition requiring or otherwise providing for the making of modifications to the conditions of a licence.
26. The Authority has given notice that it proposes to grant consent to Transco in respect of the proposed transfers of the four relevant Additional Transco Licences subject to conditions requiring or otherwise providing for the making of modifications to each of the four relevant Additional Transco Licences in respect of the IDNs.
27. Without fettering the Authority's discretion, it is expected that the modification to the four Additional Transco Licences in respect of the IDNs, if made, would be made in parallel to the modifications to the Original Transco Licence and the RDN Additional Transco Licence which are the subject of this Notice.

Representations and objections

28. Any representations or objections with respect to the proposed modifications to the Original Transco Licence and the RDN Additional Transco Licence must be made before 5.00pm on Friday 15 April 2005 and should be addressed to:

Sonia Brown

Ofgem

9 Millbank

⁸ Notice of proposed consent to transfer the four Additional Transco Licences relating to the IDN from Transco to four wholly owned Transco subsidiary companies published on the same date as this Notice pursuant to section 8AA of the Act

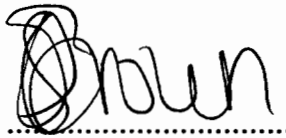
London

SW1P 3GE

Email: Helen.connolly@ofgem.gov.uk

29. Respondents are free to mark their reply as confidential, although we would prefer, as far as possible, open responses that can be placed in the Ofgem library. Ofgem would also prefer that non-confidential responses are sent electronically so that they can be placed on the Ofgem website.

30. If you wish to discuss any aspect of this Notice, Helen Connolly (telephone 020 7901 7267) would be pleased to help.



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Sonia Brown

Director, Transportation

Duly authorised on behalf of the Authority

14 February 2005

Annex 1

1. REASONS FOR PROPOSED MODIFICATIONS

The reasons why the Authority proposes to make the modifications set out in this Notice to the Original Transco Licence and to the RDN Additional Transco Licence and their effects are set out in the following documents:

- 1.1 *National Grid Transco – Potential sale of gas distribution network businesses. Formal consultation under Section 23 and Section 8AA of the Gas Act 1986 February 2005;*
- 1.2 *Notice of proposed consent to transfer the four Additional Transco Licences relating to the IDN from Transco to four wholly owned Transco subsidiary companies published on 14 February 2005 pursuant to section 8AA of the Act*
- 1.3 *National Grid Transco – Sale of gas distribution networks. Authority Decision. Transco plc applications to dispose of four gas distribution networks;*
- 1.4 *Direction issued by the Authority on 1 February 2005 re modification of the price control conditions in each of Transco plc's six gas transporter licences;*
- 1.5 *DN Sales: Open Letter to Transco regarding credit cover arrangements for gas transportation use of system and connection charges 17 December 2004;*
- 1.6 *Erratum to Final Impact Assessments 2 December 2004;*
- 1.7 *National Grid Transco– potential sale of gas DN business – Licensing: Next Steps – Formal consultation under section 23 and informal consultation under section 8AA of the Gas Act 1986;*
- 1.8 *National Grid Transco – Potential Sale of Gas distribution network businesses – Final Impact Assessment – November 2004;*
- 1.9 *National grid Transco – Potential sale of gas distribution network businesses – Final Impact assessment – Appendices – November 2004;*
- 1.10 *Transco plc – Form of five new additional GT licences granted to Transco plc on 5 November 2004 – 5 November 2004;*

- 1.11 *Transco plc – Notice of the grant of five new additional gas transporter licences – 5 November 2004;*
- 1.12 *Joint Ofgem and DTI open letter – Sale of NGT's Local Gas Distribution Networks (DNs): Issue of an exemption from a shipper's licence – 4 November 2004;*
- 1.13 *DN Sales: Ofgem note on initial draft of private CLM licence condition – 19 October 2004;*
- 1.14 *Open letter: updated timetable for potential gas distribution network sales project – 15 October 2004 – 238/04;*
- 1.15 *DN Sales: Gas distribution price controls further clarification – 6 October 2004;*
- 1.16 *DN Sales: National Grid Transco – potential sale of gas distribution network businesses – publication of NGT's initial drafting of proposed new NTS/GT licences – 15 September 2004;*
- 1.17 *National Grid Transco – potential sale of gas distribution network businesses; Initial thoughts on restructuring of Transco plc's gas transporter licences; Consultation document. September 2004 – 215/04;*
- 1.18 *Open letter on Special Condition 18 – 26 August 2004;*
- 1.19 *Ofgem preliminary position on business separation requirements to apply between distribution networks – 20 August 2004;*
- 1.20 *Offtake arrangements, conclusions document on framework – 13 August 2004 – 199/04;*
- 1.21 *Interruptions arrangements: conclusions on document framework – 13 August 2004 – 198/04;*
- 1.22 *DN Sales: open letter to NGT, potential DN purchasers and other parties on licence amendment process – 5 August 2004;*
- 1.23 *DN Sales: Ofgem position paper on pensions – 2 August 2004;*
- 1.24 *DN Sales: Open letter on environmental liabilities – 23 July 2004;*

- 1.25 *Transco plc – Notice of proposed grant and proposed modification of 8 new additional gas transporters licences – 22 July 2004;*
- 1.26 *Open letter: timetable for potential gas distribution network sales project – 16 July 2004;*
- 1.27 *National Grid Transco – potential sale of gas distribution network businesses. Interruptions arrangements: regulatory impact assessment. 30 June 2004 - 146/04;*
- 1.28 *National Grid Transco – potential sale of gas distribution network businesses. Offtake arrangements. Regulatory impact assessment. 11 June 2004 - 131/04;*
- 1.29 *National Grid Transco – potential sale of network distribution businesses Agency and governance arrangements – 28 May 2004 120/04;*
- 1.30 *National Grid Transco – potential sale of network distribution businesses. Allocation of roles and responsibilities between transmission and distribution network – 28 May 2004 – 119/04s;*
- 1.31 *DN Sales: RIA on options for exit reform industry letter – 20 May 2004;*
- 1.32 *National Grid Transco – potential sale of network distribution businesses. Allocation of roles and responsibilities between transmission and distribution networks – regulatory impact assessment. 20 April 2004 – 84/04;*
- 1.33 *National Grid Transco – potential sale of network distribution businesses. Agency and governance arrangements: regulatory impact assessment. 20 April 2004 – 83/04;*
- 1.34 *Open letter on Gas Distribution Price Controls – 16 March 2004;*
- 1.35 *National Grid Transco – potential sale of network distribution businesses: next steps. 17 December 2003 – 170/03; and*
- 1.36 *National Grid Transco – potential sale of network distribution businesses. 31 July 2003 – 77/03.*

2. Copies of the above documents are available (free of charge) from the Ofgem Research and Information Centre (telephone 020 7901 7003) or on the Ofgem website (www.ofgem.gov.uk).

Annex 2

Explanation of the proposed modifications to the Original Transco Licence and the RDN Additional Transco Licence

The first two columns of the table below explain the proposed changes to the Original Transco Licence (in respect of the NTS) and the RDN Additional Transco Licence (in respect of the RDNs) which are the subject of this Notice.

For information only, the final four columns show the changes which are being proposed as part of the Authority's proposal to grant consent to Transco under section 8AA of the Act to transfer the four Additional Transco Licences which relate to the four IDNs which are proposed to be hived-down to four wholly owned Transco subsidiary companies. For the avoidance of doubt, the proposed changes to the four Additional Transco Licences which relate to the IDNs are being proposed pursuant to a separate but related notice published by the Authority pursuant to section 8AA of the Act at the same time as this Notice.

The actual proposed tests of the modified and restructured licences are set out in Appendices 7 to 8 to the explanatory document which accompanies this Notice (the "Explanatory Documents")

Licence	The Original Transco Licence re Transco NTS ¹	The RDN Additional Transco Licence re the RDNs ²	The Additional Transco Licence re the North Distribution Network ³	The Additional Transco Licence re the Scotland Distribution Network ³	The Additional Transco Licence re the South Distribution Network ³	The Additional Transco Licence re the Wales and West Distribution Network ³
Standard Conditions applicable to all NTS and DN GTs (Set out in Appendix 7 to the Explanatory Document) 4	✓	✓	✓	✓	✓	✓
Standard Special Conditions applicable to the all NTS and DN GTs – Part A (Set out in	✓	✓	✓	✓	✓	✓

Appendix 8A to the Explanatory Document)						
Standard Special Conditions applicable to all NTS GTs – Part B5 (Set out in Appendix 8B to the Explanatory Document)	✓	×	×	×	×	×
Special Conditions applicable to the Transco NTS GT – Part C (Set out in Appendix 8C to the Explanatory Document)	✓	×	×	×	×	×
Standard Special Conditions applicable to all DN GTs – Part D6 (Set out in Appendix 8D to the Explanatory Document)	×	✓	✓	✓	✓	✓
Special Conditions Part E Part 1 applicable to the RDNs only (Set out in Appendix 8E (1) to the	×	✓	×	×	×	×

Explanatory Document)						
Special Conditions Part E Part 2 applicable to the North of England DN only (Set out in Appendix 8E (2) to the Explanatory Document)	×	×	✓	×	×	×
Special Conditions Part E Part 3 applicable to the Scotland DN only (Set out in Appendix 8E (3) to the Explanatory Document)	×	×	×	✓	×	×
Special Conditions Part E Part 4 applicable to the South of England DN only (Set out in Appendix 8E (4) to the Explanatory Document)	×	×	×	×	✓	×
Special Conditions Part E Part 5 applicable to the Wales &	×	×	×	×	×	✓

West DN only (Set out in Appendix 8E (5) to the Explanatory Document)						
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¹ This is the Original Transco Licence. This is being modified as part of this Notice.

² This is the RDN Additional Transco Licence. This is being modified as part of this Notice. Standard Special Condition E10 (Separation of NTS and DN distribution network business) applies to the RDN Additional Transco Licence only and does not apply to the IDNs.

³ This is being modified as part of a separate notice pursuant to section 8AA of the Act which has been published at the same time as this Notice. Special Standard Condition E11 (Amendment to the Credit Rating of the Licensee) augments Standard Special Condition A38 (Credit Rating of the Licensee) and applies to the IDNs in the period between hive down and share sale). This does not apply to either in the Original Transco Licence or in the RDN Additional Transco Licence.

⁴ It should be noted that certain Standard Conditions will be switched off in the NTS and DN GT licences. These are explained in Appendix 4 to the Explanatory Document which accompanies this Notice.

⁵ & ⁶ It should be noted that paragraphs 1-4 and 8 of proposed Standard Special Conditions B1 and D1 will be operative in all licences.