

To:

The Company Secretary  
Transco plc  
1 – 3 Strand  
London  
WC2N 5EH

## **MODIFICATION TO TWO OF THE SIX GAS TRANSPORTERS LICENCES HELD BY TRANSCO PLC<sup>1</sup>**

### **DIRECTION PURSUANT TO SECTION 23 OF THE GAS ACT 1986 (the “Direction”)**

#### **Summary**

1. This Direction is made by the Gas and Electricity Markets Authority (the “Authority”) in connection with National Grid Transco plc’s (“NGT”) proposed sale of one or more of Transco plc’s (“Transco”) (a company registered in England and Wales with company number 2006000) local gas distribution networks (“DNs”) (the “Proposed Transaction”).
2. For the avoidance of doubt, it should be noted that while this Direction is made today pursuant to Section 23 of the Gas Act 1986 (the “Act”) the modifications will only be brought into effect when the Authority issues a second direction (the Associated Direction as described in paragraph 27 of this Direction).<sup>2</sup>

#### **Background**

3. Transco 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”).
4. 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

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<sup>1</sup> As described further in this Direction, the two licences to which this Direction relates are the Original Transco Licence relating to the NTS and the Additional Transco Licence relating to the RDNs (as defined in this Direction).

<sup>2</sup> The Associated Direction will relate to the bringing into effect of this direction, including the making and implementation of Standard Special Conditions Part A direction(s), Standard Special Conditions Part B direction(s), Standard Special Conditions Part D direction(s) and the exercise of the power to make (with the licensee’s consent) TSO direction(s) in such manner as the Authority considers appropriate.

additional GT licences which the Authority was minded to grant on the basis that any surplus licences could be revoked.

5. 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 Transco<sup>3</sup> and Transco formally withdrew its remaining three applications. As a result of this, as at the date of this Direction, 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 website<sup>4</sup>.
6. The Original Transco Licence and the five Additional Transco Licences are together referred to in this Direction as the "Transco Licences".
7. Until 1 February 2005, all gas transportation assets owned by Transco were operated pursuant to the Original Transco Licence and 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**

8. 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 Licences<sup>5</sup> (the "Initial S.23 Notice") together with an explanatory document<sup>6</sup>.
9. The Initial S.23 Notice consulted 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 DNs which are proposed to be disposed of by Transco (the "IDNs") and each of those DNs 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.

<sup>3</sup> 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.

<sup>4</sup> [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_copy_of_the_GT_Licences_issued_to_Transco_05.11.04.pdf)

<sup>5</sup> [http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1\\_8936#top8936](http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1_8936#top8936)

<sup>6</sup> 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

### The Proposed Transaction

10. As part of the Proposed Transaction, Transco is proposing to hive-down the four IDNs as follows<sup>7</sup>:

DN	Wholly Owned Transco Subsidiary
The North of England DN	Blackwater F Limited
The Scotland DN	Blackwater SC A Limited
The South of England DN	Blackwater G Limited
The Wales and West DN	Blackwater 2 Limited

11. Simultaneously, Transco is proposing to transfer respectively four of the five Additional Transco Licences (which relate to the respective IDNs) to each of the four relevant wholly owned subsidiary companies listed in paragraph 10 above (the "Proposed Transfers").
12. After hive-down of the four IDNs and transfer of the four Additional Transco Licences relating to the IDNs, Transco then proposes to sell the shares in each of the four relevant wholly owned subsidiary companies to third party purchasers. Transco would retain one of the five Additional Transco licences in respect of its RDN business and the Original Transco Licence in respect of its NTS business (it is proposed that both licences be held by Transco in the same legal entity).

### Consents

13. The proposed hive-down by Transco of the four relevant IDNs from Transco to the four relevant wholly owned subsidiary companies 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 provided that the Authority granted its consent to Transco to hive-down the four relevant IDNs under Amended Standard Condition 29 of the Original Transco Licence.
14. 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

<sup>7</sup> as detailed at paragraph 9 above the four RDNs are proposed to be retained by Transco.

to dispose of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies as part of the Proposed Transaction.

15. On 20 January 2005, the Authority met at a duly convened Authority meeting to consider Transco's applications. After careful consideration, the Authority granted four conditional consents (the "Consents Directions") to Transco under Amended Standard Condition 29 of the Original Transco Licence to dispose of each of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies. Such disposal is not permitted to take place prior to 1 May 2005. As the consents contained in the Consents Directions were granted on a conditional basis<sup>8</sup>, Transco is required to satisfy a number of conditions precedent before the consents become effective. In addition, the Authority also attached a number of conditions subsequent to its consent. In particular, and without limitation, the Authority's further consent is required in relation to a number of areas of the Proposed Transaction. For example, Transco is prohibited from disposing or relinquishing control (directly or indirectly) of the shares in the four relevant wholly owned subsidiary companies without the prior written consent of the Authority.
16. 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<sup>9</sup>.

### **Initial Section 23 Notice and direction to modify the Licences**

17. 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 2005<sup>10</sup>.
18. As a result, 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 Direction, four of the Additional Transco Licences respectively relate only to each of the four IDNs to be disposed of by Transco,

<sup>8</sup> For further detail on the conditions to consent – see Appendix 2 to the Authority January 2005 Decision document [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074\\_2105b.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074_2105b.pdf)

<sup>9</sup> [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

<sup>10</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043\\_2405.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043_2405.pdf)

one of the Additional Transco Licences relates only to the four RDNs to be retained by Transco and the Original Transco Licence relates only to the NTS although all the Transco Licences continue to be held by Transco. On the date on which this Direction comes into effect, the four relevant Additional Transco Licences relating to the IDNs will be transferred to the four relevant Transco wholly owned subsidiary companies which will hold the assets regulated by those licences. This will be done by way of separate direction pursuant to section 8AA of the Act, as described further at paragraph 34 below.

### **Modifications to the Original Transco Licence and the Additional Transco Licence relating to the RDNs**

19. On 14 February 2005, the Authority pursuant to section 23(3) of the Act gave notice (the “Second S.23 Notice”)<sup>11</sup> that it was proposing, as part of the Proposed Transaction, to modify the conditions of the Original Transco Licence and the Additional Transco Licence relating to the RDNs as set out in the Second S.23 Notice, the annexes and the explanatory document (including its appendices) which accompanied the Second S.23 Notice<sup>12</sup>. The proposed modifications to the Original Transco Licence relating to the NTS and the Additional Transco Licence relating to the RDNs were discussed and explained in the explanatory document which accompanied the Second S.23 Notice. On the same day, the Authority also issued an associated Section 8AA Notice (the “Associated S.8AA Notice”) proposing modifications to the four Additional Transco Licences relating to the IDNs as a condition to the Proposed Transfers and consulting on its proposal to consent to the Proposed Transfers.
20. The Authority sent a copy of the Second S.23 Notice to the Secretary of State and has not received any objection or direction not to make the modifications to the Original Transco Licence and the Additional Transco Licence relating to the RDNs.
21. The Second S.23 Notice stated that in order to make the modifications set out in the Second S.23 Notice to the Original Transco Licence and the Additional Transco Licence relating to the RDNs Transco’s consent would be required in accordance with the requirements of section 23(6) of the Act as it would be the holder of the relevant licences. It was explained that this meant that only Transco would be asked to provide consent to the proposed modifications. However, it was also explained that, in the light of the Proposed

<sup>11</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10219\\_10219\\_Appendix6S23Notice.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10219_10219_Appendix6S23Notice.pdf)

<sup>12</sup> 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

Transaction, Ofgem would particularly hope to receive comments on the proposed modifications to the Original Transco Licence and the Additional Transco Licence in relation to the RDNs from, amongst others, potential DN purchasers and other interested parties.

### **Responses to the Second Section 23 Notice and Associated S.8AA Notice**

22. Prior to the close of the consultation period in respect of the Second S.23 Notice and Associated S.8AA Notice, the Authority received 16 responses (excluding Transco's response) none of which were marked as confidential<sup>13</sup>. No responses were withdrawn. The responses, with the exception of the one response which, while not confidential, the respondent requested not be published, have been placed in the Ofgem library and are available on the Ofgem website<sup>14</sup>.
23. A summary of respondents' views is attached in Schedule 1 to this Direction.
24. The Authority has carefully considered representations or objections made to it and not withdrawn in relation to its proposal to modify the Original Transco Licence and Additional Transco Licence relating to the RDNs.
25. Following publication of the Second S.23 Notice and Associated S.8AA Notice, Ofgem received notification of and identified a number of minor non-material errors in the drafting provided in relation to the proposed modifications. Details of such minor non-material errors are set out in Schedule 2 to this Direction.
26. In the Authority's view, the above corrections and changes are non-material. Having considered the errors and having regard to its powers and duties under the Act, the Authority has decided to incorporate each of the corrections and changes without further consultation and considers that these changes fall within section 23 of the Act.

### **Other Decisions made by the Authority**

27. At a duly convened meeting of the Authority today and consistent with its decision in January 2005 (described at paragraph 15 above), the Authority considered various other matters relating to the Proposed Transaction in addition to consideration of the proposed modifications to the Original Transco Licence and the Additional Transco Licence relating to the RDNs as described above. In relation to the consideration of conditions precedent

<sup>13</sup> One respondent noted that its request was not confidential but requested that Ofgem did not post its response on Ofgem's website.

<sup>14</sup> [http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1\\_9669#top9669](http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1_9669#top9669)

contained in the Consents Directions, the Authority has today issued an open letter (the "Conditions Precedent Letter")<sup>15</sup> stating that the conditions precedent had been sufficiently satisfied to allow hive-down on 1 May 2005 (or such later date as the Authority may direct in writing). However, in the Conditions Precedent Letter, the Authority indicated that before hive-down could complete, the Authority intended to write to Transco requesting its confirmation that the conditions precedent had been fully satisfied. Recognising the inter-relationship between this decision and the proposed modifications, the Authority noted that the sequencing of its inter-related decisions would have to be addressed. Accordingly, it decided that, whilst it proposed to grant its Consent and make the proposed modifications to the Original Transco Licence and the Additional Transco Licence relating to the RDNs today, the coming into effect of this Direction would take place by way of a separate direction (the "Associated Direction").

28. On 25 April 2005, as required under section 23 of the Act, Transco provided the Authority with its written consent to the making of the proposed modifications to each of the Original Transco Licence and the Additional Transco Licence relating to the RDNs today in the form set out in Schedule 3 to this Direction, such modifications to take effect by way of the Associated Direction.

#### **Direction to modify**

29. With the written consent of Transco (as required in terms of section 23 of the Act) and in accordance with the powers contained in section 23 of the Act, the Authority hereby directs that the Original Transco Licence and the Additional Transco Licence relating to the RDNs be modified today in the form set out in Schedule 3 to this Direction but that such modifications shall take effect on 1 May 2005 (or such later date as the Authority may direct in writing) by way of a separate Associated Direction (as described in paragraph 30 below).
30. The proposed modifications (whilst made) shall not take effect:
  - 30.1 until the Authority has received a report from Transco updating the Authority on the status of the Proposed Transfers as set out in Conditions Precedent Letter and, having considered that report, the Authority has issued a letter reaffirming its consent to the Proposed Transfers; and

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<sup>15</sup> Please refer to Ofgem Open letter: Ofgem approves next stage of NGT's sale of four of its gas distribution networks – 25 April 2005 <http://www.ofgem.gov.uk>

- 30.2 in any event, before the Authority has issued the Associated Direction.
31. If any of the conditions set out in paragraph 30 are not satisfied in full or if at any stage the Authority is of the opinion that any such condition is unlikely to be satisfied, the Authority shall be entitled at its sole discretion to:
- 31.1 waive the unsatisfied condition or conditions;
  - 31.2 extend the period for satisfying the unsatisfied condition or conditions to an alternative date; or
  - 31.3 vary or otherwise modify any unsatisfied condition or conditions.
32. Pursuant to section 38A of the Act the reasons for making this Direction to modify the Original Transco Licence and Additional Transco Licence relating to the RDNs as set out in the Schedules to this Direction are stated in:
- 32.1 the Second S.23 Notice;
  - 32.2 the documents listed in the Second S.23 Notice; and
  - 32.3 the Associated S.8AA Notice;
  - 32.4 the documents listed in the Associated S.8AA Notice; and
  - 32.5 the direction issued by the Authority in relation to the Associated S.8AA Notice (referred to in paragraph 34 below)
33. Copies of the documents referred to in paragraph 32 are available (free of charge) from the Ofgem library, 9 Millbank, London SW1P 3GE (telephone 020 7901 7003) or on the Ofgem website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

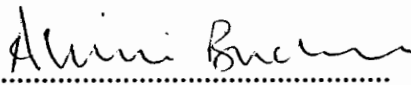
#### **Additional information**

34. It should be noted that the Authority has today also published a separate but related direction under section 8AA of the Act (in connection with the Proposed Transaction) granting its consent to Transco to the Proposed Transfers and modifying (in connection with the Proposed Transaction) the four Additional Transco Licences relating to the IDNs. The modification to the four Additional Transco Licences relating to the IDNs will be made in parallel to the modifications to the Original Transco Licence and the Additional Transco Licence relating to the RDNs which are the subject of this Direction.



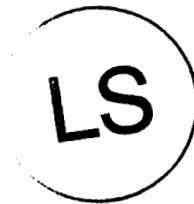
35. In issuing this Direction, it is important to make clear that following the Authority's decision in relation to the Proposed Transaction on 20 January 2005, there can be no expectation on the part of NGT, Transco, shippers, suppliers, potential DN purchasers or any other interested parties as to 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 subsequent attached to the consents granted by the Authority on 20 January 2005) in relation to the Proposed Transaction. The Authority's discretion will not be fettered by any statements made in this Direction.

The Official Seal of the Gas and Electricity Markets Authority affixed to this Direction and is authenticated by:



Alistair Buchanan  
Chief Executive Officer

Duly authorised by the  
Gas and Electricity Markets Authority



25 April 2005

**SCHEDULE 1**

**RESPONDENTS' VIEWS**

Please refer to the attached separate document

**SCHEDULE 2**

**NON MATERIAL CORRECTIONS**

Please refer to the attached separate document

## Schedule 2: Table of corrections

1. As part of this Direction, and having regard to its powers and duties under the Act, the Authority has decided to incorporate a number of non-material corrections into the licence drafting, as published within the S.8AA Notice and Associated Section 23 Notice published on 14 February 2005, without further consultation. These changes represent correction of minor typographical or cross-referencing errors which have arisen as part of the changes proposed and are reflected in the licence drafting provided in Schedule 3. The Authority considers that these changes fall within section 8AA and section 23 of the Act. These changes have come to Ofgem's attention as the result of either:
  - ♦ responses to the February document (which are summarised in Schedule 1); or
  - ♦ internal Ofgem review of the drafting.
2. The licence drafting provided in Schedule 3 does not identify revisions, however, these are detailed in the table below.

Part of licence	Condition	Paragraph	Description of correction
Part A	Standard Special Condition A1. Application/Disapplication of standard conditions in Section A (Interpretation, Application and Payments) and Section B (General) and Application/Disapplication of Standard Special Conditions applicable to both NTS and DN licensees	8	Replace "notice issued under paragraph 7" with "notice issued under paragraph 6".
	Standard Special Condition A10. Provision and Return of Meters	6	Replace "standard condition 5 (System Development Obligations)" with "Standard Special Condition A50 (System Development Obligations)"

Part of licence	Condition	Paragraph	Description of correction
	Standard Special Condition A11. Network Code and Uniform Network Code	24(a)	In the definition of “network code modification procedures”, replace “referred to in paragraph 6” with “referred to in paragraph 7”.
	Standard Special Condition A49. Designated Registrar of Pipes	4(a)	Replace “Standard Special Condition A50 (Information to be Provided to a Designated Registrar of Pipes)” with “Standard Special Condition A51 (Information to be Provided to a Designated Registrar of Pipes)”.
		4(b)	
		4(c) line 6	
		4(c) line 10	
	Standard Special Condition A50. System Development Obligations	8(c)(iii)	Insert line break before “(iv)”.
		10(b)	Insert line break after “premises,”
Part B	Standard Special Condition B1. Application/Disapplication of standard conditions in Section A (Interpretation, Application and Payments) and Section B (General) and Application/Disapplication of Standard Special Conditions applicable to NTS licensees	8	Replace “notice issued under paragraph 7” with “notice issued under paragraph 6”.
Part C	Special Condition C3. Restriction of Prices for LNG Storage Services	1(3)	Correct cross-reference such that “Regards” is changed to “Regard”.
	Special Condition C4. Prohibited Procurement Activities	3	In the definition of “balancing trade”, insert closing brackets after “code”.
	Special Condition C8B: Restriction of revenue in respect of the NTS transportation owner activity and NTS system operation	2(1)	In the definition of “TOExR <sub>i</sub> ”, replace “ $t > 4$ ” with “ $t \geq 4$ ”.
		14(5)(c)(ii)	Replace “Standard Special Condition A5(5)(aa)(ii) (Charging – General)” with “Standard
		14(5)(c)(iii)(aa)	

Part of licence	Condition	Paragraph	Description of correction
	activity	14(5)(f)(ii)(a)	Special Condition A5(5)(aa)(ii) (Obligations as Regard Charging Methodology)"
Part D	Standard Special Condition D1. Application/Disapplication of standard conditions in Section A (Interpretation, Application and Payments) and Section B (General) and Application/Disapplication of Standard Special Conditions applicable to DN licensees	8	Replace "notice issued under paragraph 7" with "notice issued under paragraph 6".
	Standard Special Condition D2. Private Collective Licence Modification Procedure in respect of Standard Special Conditions applicable to DN licensees	3(c)	Replace "shall not to be entitled" with "shall not be entitled"

**SCHEDULE 3**

**FORM OF LICENCE MODIFICATIONS**

Please refer to the attached separate document.