

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

**MODIFICATION PROPOSED TO SIX GAS TRANSPORTERS
LICENCES HELD BY TRANSCO PLC¹**

This notice (the "**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**").

The Authority pursuant to section 23(3) of the Act gives notice that it proposes to modify the six gas transporters ("**GT**") licences currently held by Transco. This Notice is issued in two parts. Part 1 relates to general modifications to deal with respondents' views to the consultation conducted by the Authority in relation to the S.8AA Notice and the Second S.23 Notice (each as hereinafter defined) and Part 2 relates to the introduction of interim incentive arrangements. If, following consideration of respondents' views in relation to this Notice, the Authority considers that all or any of the modifications proposed in one or both of these Parts should not be made or that such modifications should be made at different times, the Authority, in its discretion, may consider it appropriate to direct the modifications proposed in this Notice in part only.

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.

¹ Pursuant to a consent direction issued by the Authority on 25 April 2005, it is anticipated that four of the six GT licences currently held by Transco (relating to the four DNs to be sold) will be transferred to four wholly owned Transco subsidiaries.

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 Licences**”) rather than the eight originally applied for by Transco² 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 Licences were granted in substantially the same form as the Original Transco Licence and a copy of the form in which the Additional Licences were granted can be found on Ofgem’s website³.
4. The Original Transco Licence and the five Additional Licences are together referred to in this Notice as the “**Six 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 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 Six Licences⁴ (the “**Initial S.23 Notice**”) together with an explanatory document⁵.
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 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

² 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

³http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9161_A_copy_of_the_GT_Licences__issued_to_Transco__05.11.04_1.pdf

⁴ http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1_8936#top8936

⁵ 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 five Additional 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 North of England DN, the Scotland DN, the South of England DN and the Wales and West DN) to four wholly owned Transco subsidiary companies respectively (Blackwater F Limited, Blackwater SC A Limited, Blackwater G Limited and Blackwater 2 Limited). In addition, Transco is proposing to transfer four of the five Additional 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.
9. The proposed hive-down of the four relevant IDNs from Transco to the four relevant wholly owned subsidiary companies requires, 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 in a duly convened meeting 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 (the "**Consents Directions**")⁶. 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

⁶ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10034_2105.pdf

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 Licences, the Authority issued a direction modifying the licence conditions in each of the Six Licences in the manner largely specified in the Initial S.23 Notice respectively with effect from 1 February 2005⁷. 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, four relevant Additional Licences respectively relate only to each of the four IDNs to be disposed of by Transco (referred to in this Notice as the "**IDN Additional Licences**"), one of the Additional 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.

The Modification Process to date: February 2005 Section 8AA and Section 23 Notices.

14. As part of the Proposed Transaction pursuant to section 23(3) and section 8AA of the Act, on 14 February 2005 the Authority published two notices proposing modifications to each of the Six Licences⁸ together with an explanatory document⁹. The notice published pursuant to section 8AA of the Act (the "**S.8AA Notice**") gave notice that the Authority proposed to grant consent to transfer

⁷ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043_2405.pdf

⁸ http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&llevelids=,1_9669#top9669

⁹ 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

each of the IDN Additional Licences from Transco to the four relevant wholly owned Transco subsidiary companies (the “**Proposed Transfers**”). The S.8AA Notice also proposed that as a condition of the consent to the Proposed Transfers, each of the IDN Additional Licences would be modified. The notice published pursuant to section 23(3) of the Act (the “**Second S.23 Notice**”) proposed to modify the Original Transco Licence and the RDN Additional Transco Licence.

15. The S.8AA Notice and the Second S.23 Notice sought to consult on the Authority’s proposal (as part of the Proposed Transaction) to restructure the Six Licences to ensure that they could operate in a divested industry structure. The S.8AA Notice and the Second S.23 Notice stated that the effect of the proposed modifications would be to restructure each of the IDN Additional Licences, the RDN Additional Transco Licence and the Original 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.
16. On 25 April 2005 the Authority met at a duly convened Authority meeting to consider certain matters relating to the Proposed Transaction including, without limitation, the conditions precedent attached to the Consent Directions, Urgent Modification Proposal 0745 relating to Transco’s Network Code and the consultation conducted pursuant to the S.8AA Notice and the Second S.23 Notice.
17. Having had due regard to its principal objective and statutory and other public law duties and the statutory duties of GTs, and having carefully considered representations received in response to the various consultations, on 25 April 2005, the Authority:
 - a. issued an open letter (the “**ASC 29 Decision Letter**”) stating that the conditions precedent to the Consent Directions had been sufficiently satisfied to allow hive-down on 1 May 2005 (or such later date as the Authority may direct in writing)¹⁰;

¹⁰ 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.

- b. issued a decision letter relating to Urgent Modification Proposal 0745 (the "**0745 Decision Letter**") stating that the Authority approved Urgent Modification Proposal 0745 to Transco's network code to take effect on 1 May 2005 (or such later date as the Authority may direct) and, accordingly, on 1 May 2005, or such later date as the Authority may direct, Transco's existing network code would therefore become the NTS and RDN businesses' short form code;
- c. issued a consent and direction pursuant to section 8AA of the Act (the "**S.8AA Consent and Direction**") directing that each of the IDN Additional Licences be modified on 25 April 2005 but that such modifications would take effect on 1 May 2005 (or such other date as the Authority may direct) by way of a separate direction (the "**S.8AA Associated Direction**") and consenting to the transfer of the four IDN Additional Licences from Transco to the four relevant wholly owned Transco subsidiary companies; and
- d. issued a direction pursuant to section 23 of the Act (the "**Second S.23 Direction**") directing that the Original Transco Licence and the RDN Additional Transco Licence be modified on 25 April 2005 but that such modifications would take effect on 1 May 2005 (or such other date as the Authority may direct) by way of a separate direction (the "**S.23 Associated Direction**").

The sequencing of the above decisions, including the 0745 Decision Letter will be addressed in the S.8AA Associated Direction and the S.23 Associated Direction.

18. As a result of the ASC29 Decision Letter, the 0745 Decision Letter, the S.8AA Consent and Direction and the Second S.23 Direction the Authority has permitted Transco to take the necessary steps towards proceeding to hive-down on 1 May 2005 (or such later date as the Authority may direct). However, as stated in each of those documents, although made on 25 April 2005, the relevant modifications and decisions shall not come into effect until the Authority issues a further direction or series of directions. Accordingly, as at the date of this Notice, Transco has been permitted to proceed to take steps towards hive-down and, without fettering the Authority's discretion, it is anticipated that

on 1 May 2005 (or such later date as the Authority may direct) amongst other things, the modifications to restructure the Six Licences will be brought into effect, Transco's network code will be modified to become the NTS and RDN businesses' short form code and each of the IDN Additional Licences will be transferred from Transco to respectively each of Blackwater G Limited, Blackwater F Limited, Blackwater 2 Limited and Blackwater SC A Limited together with the DN assets to which each of the IDN Additional Licences relates.

The modification process to date: the need for further modifications

19. Under NGT's commercial timetable for the Proposed Transaction, at the time of hive-down, the regulatory arrangements which, in the Authority's opinion, will be necessary to protect the interests of customers in a divested industry structure will not be fully in place. Further modifications to each of the Six Licences would therefore be required in order to seek to ensure that customers' interests are protected in a divested industry structure.
20. In order to make the modifications set out in this Notice to the Six Licences, the consent of the licensee is required. As it is anticipated that each of the IDN Additional Licences will respectively transfer to each of Blackwater G Limited, Blackwater F Limited, Blackwater 2 Limited and Blackwater SC A Limited on 1 May 2005 (or such later date as the Authority may direct), it is anticipated that Transco's consent and the consent of Blackwater G Limited, Blackwater F Limited, Blackwater 2 Limited and Blackwater SC A Limited will be required in accordance with the requirements of section 23(6) of the Act as it is anticipated that they will be the respective holders of the relevant licences at the relevant time. However, if the Authority has not directed hive-down, only the consent of Transco as holder of the Six Licences would be required. If the relevant consents are provided, this would enable the Authority, but not oblige it, to direct that the modifications be made.
21. However, in light of the Proposed Transaction, Ofgem would particularly hope to receive comments on the proposed modifications to the Six Licences from, amongst others, potential DN purchasers and other interested parties.

Private CLM process

22. The Authority further notes that three of the conditions introduced (but not brought into effect) into the Six Licences by the S.8AA Consent and Direction and the Second S.23 Direction were Standard Special Conditions A2, B2 and D2 which contained the private collective licence modification procedure (the "Private CLM Conditions"). As the Private CLM Conditions have not yet been brought into effect in the Six Licences as explained above, the Authority has not proposed to make the modifications proposed to Parts A, B and/or D of the Six Licences, which are part of the subject of this Notice, using the powers contained in these conditions. However, the Authority would note that, had the Private CLM Conditions been effective in each of the Six Licences, the powers contained in those conditions would have been used in relation to conditions proposed to be introduced into Parts A, B and/or D respectively although the Special Conditions in Parts C and D would still be subject to the modification procedure provided in section 23 of the Act. Accordingly, when the relevant licence holders are asked to consent to the modifications proposed in this Notice, they will also be asked to confirm their acceptance that conditions to be introduced into Parts A, B and/or D will be capable of being modified in the future using the Private CLM conditions in addition to the modification procedure provided in section 23 of the Act. Therefore, no adverse inference should be drawn from the Authority's decision to issue this Notice pursuant to section 23 of the Act at this time.

Additional Information

23. In issuing this Notice it is important to make clear that after the Authority's decisions in relation to the Proposed Transaction on 20 January 2005 and 25 April 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 subsequent attached to the consents granted by the Authority on 20 January 2005) in relation to the Proposed Transaction.

24. 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

25. This notice is in two parts. Part 1 relates to general modifications to deal with respondents' views to the consultation conducted by the Authority in relation to the S.8AA Notice and the Second S.23 Notice and Part 2 relates to the introduction of interim incentive arrangements and certain general modifications to the price control conditions to deal with respondents' views to the consultation conducted by the Authority in relation to the S.8AA Notice and the Second S.23 Notice. If, following consideration of respondents' views in relation to this Notice, the Authority considers that all or any of the modifications proposed in one or both of these Parts should not be made or that such modifications should be made at different times, the Authority, in its discretion, may consider it appropriate to direct the modifications proposed in this Notice in part only.

Part 1: Issues raised by respondents as a result of consultation on the S.8AA Notice and Second S.23 Notice

26. The Authority proposes, as part of the Proposed Transaction, to modify the conditions of each of the Six Licences as set out in this Notice, the Annexes and the explanatory document (including its appendices) which accompanies this Notice as follows:

27. In each of the Six Licences, by substituting for existing conditions:

- a. Standard Special Condition A3 (Definitions and Interpretation);
- b. Standard Special Condition A4 (Charging - General);
- c. Standard Special Condition A5 (Obligations as Regard Charging Methodology);

- d. Standard Special Condition A8 (Emergency Services and Enquiry Service Obligations);
- e. Standard Special Condition A11 (Network Code and Uniform Network Code);
- f. Standard Special Condition A12 (Joint Office Governance Arrangements);
- g. Standard Special Condition A15 (Agency);
- h. Standard Special Condition A29 (Change of Financial Year);
- i. Standard Special Condition A30 (Regulatory Accounts);
- j. Standard Special Condition A33 (Restriction on Use of Certain Information and Independence of the Transportation Business);
- k. Standard Special Condition A36 (Restriction on Activity and Financial Ring Fencing);
- l. Standard Special Condition A37 (Availability of Resources);
- m. Standard Special Condition A38 (Credit Rating of the Licensee);
- n. Standard Special Condition A39 (Indebtedness);
- o. Standard Special Condition A40 (Price Control Review Information); and
- p. Standard Special Condition A50 (System Development Obligations),

the following new conditions:

- q. Standard Special Condition A3 (Definitions and Interpretation);
- r. Standard Special Condition A4 (Charging - General);
- s. Standard Special Condition A5 (Obligations as Regard Charging Methodology);
- t. Standard Special Condition A8 (Emergency Services and Enquiry Service Obligations);

- u. Standard Special Condition A11 (Network Code and Uniform Network Code);
- v. Standard Special Condition A12 (Joint Office Governance Arrangements);
- w. Standard Special Condition A15 (Agency);
- x. Standard Special Condition A29 (Change of Financial Year);
- y. Standard Special Condition A30 (Regulatory Accounts);
- z. Standard Special Condition A33 (Restriction on Use of Certain Information and Independence of the Transportation Business);
- aa. Standard Special Condition A36 (Restriction on Activity and Financial Ring Fencing);
- bb. Standard Special Condition A37 (Availability of Resources);
- cc. Standard Special Condition A38 (Credit Rating of the Licensee);
- dd. Standard Special Condition A39 (Indebtedness);
- ee. Standard Special Condition A40 (Price Control Review Information); and
- ff. Standard Special Condition A50 (System Development Obligations).

28. A copy of the proposed modifications in paragraphs 27 (q) to 27(ff) above can be found in Appendix 7A.

29. In the Original Transco Licence only, by substituting for existing conditions:

- a. Special Condition C4 (Prohibited Procurement Activities);
- b. Special Condition C10 (Supplementary provisions of the revenue restrictions in respect of NTS transportation owner activity and the NTS system operation activity);
- c. Special Condition C15 (Licensee's methodology for determining incremental entry capacity volumes);and

d. Special Condition C20 (Separation of NTS and Distribution Network Businesses),

the following new conditions:

e. Special Condition C4 (Prohibited procurement activities);

f. Special Condition C10 (Supplementary provisions of the revenue restrictions in respect of NTS transportation owner activity and the NTS system operation activity);

g. Special Condition C15 (Licensee's methodology for determining incremental entry capacity volumes);and

h. Special Condition C20 (Separation of NTS and Distribution Network Businesses).

30. A copy of the proposed modifications to the Original Transco Licence listed in paragraph 29 above can be found in Appendix 7C.

31. In each of the IDN Additional Licences and the RDN Additional Transco Licence by substituting for existing conditions:

a. Standard Special Condition D4 (Prohibited Procurement Activities); and

b. Special Condition E4 (Supplementary provisions of the revenue restrictions in respect of the Distribution Network);

the following new conditions:

c. Standard Special Condition D4 (Prohibited Procurement Activities); and

d. Special Condition E4 (Supplementary provisions of the revenue restrictions in respect of the Distribution Network).

32. A copy of the proposed modifications to each of the IDN Additional Licences and the RDN Additional Transco Licence contained in paragraph 31(c) above can be found in Appendix 7D and copy of the proposed modifications to each of the IDN Additional Licences and the RDN Additional Transco Licence listed in paragraph 31(d) above can be found in Appendix 7E.

33. In each of the IDN Additional Licences only by substituting for existing condition Special Condition E3 (Allocation of revenues and costs for calculations under the price control in respect of the Distribution Network), new condition Special Condition E3 (Allocation of revenues and costs for calculations under the price control in respect of the Distribution Network).
34. A copy of the proposed modifications to each of the IDN Additional Licences set out in paragraph 33 above can be found in Appendix 7E.
35. For the avoidance of doubt, it should be noted that the proposed modifications in Appendix 7E are not identical and each of the IDN Additional Licences and the RDN Additional Transco Licence will not have these Special Conditions amended in the same way. Accordingly Appendix 7E is in five parts referring to each of the relevant licences as follows:
- a. Appendix 7E Part 1 contains a copy of the proposed modifications to the RDN Additional Transco Licence¹¹;
 - b. Appendix 7E Part 2 contains a copy of the proposed modifications to the IDN Additional Transco Licence which relates to the North of England Distribution Network;
 - c. Appendix 7E Part 3 contains a copy of the proposed modifications to the IDN Additional Transco Licence which relates to the Scotland Distribution Network;
 - d. Appendix 7E Part 4 contains a copy of the proposed modifications to the IDN Additional Transco Licence which relates to the South of England Distribution Network; and
 - e. Appendix 7E Part 5 contains a copy of the proposed modifications to the IDN Additional Transco Licence which relates to the Wales and West Distribution Network.

¹¹ For the avoidance of doubt and as stated in paragraph 33, no modification to Special Condition E3 in the RDN Additional Transco Licence is proposed in this Notice

Reasons for proposed modifications in Part 1

36. The reasons why the Authority is proposing to make the modifications listed in Part 1 of this Notice to the Six Licences and their effects are set out in the documents listed in Annex 1 to this Notice and the consultation document which accompanies this Notice.

Summary of the effect of proposed modifications in Part 1

37. In summary, the effect of the proposed licence modifications contained in Part 1 of this Notice is to effect changes in each of the Six Licences to capture issues raised as part of the consultation process associated with the S8AA Notice and the second S23 Notice to ensure that customers' interests are protected in a divested industry structure. The proposed modifications and their effects are discussed and explained in the explanatory document which accompanies this Notice¹².

38. The modifications in Part 1 of this Notice, if made, would take effect on such date as the Authority may specify in writing which, for the avoidance of doubt, may not be the same date as the taking effect of the modifications contained in Part 2 of this Notice.

Part 2 – Interim Incentives

39. The Authority proposes, as part of the Proposed Transaction, to modify the conditions of each of the Six Licences as set out in this Notice, the Annexes and the explanatory document (including its appendices) which accompanies this Notice as follows:

40. In the Original Transco Licence only by substituting for existing conditions:

- a. Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and the NTS system operation activity);
- b. Special Condition C8B (Restriction of revenue in respect of the NTS transportation owner activity and the NTS system operator activity); and

¹²National Grid Transco – Potential sale of gas distribution network businesses. Final Proposals for Interim Incentives and Formal consultation under section 23 of the Gas Act 1986 – April 2005

- c. Special Condition C14 (Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the NTS transportation owner activity and the NTS system operation activity);

the following new conditions:

- d. Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and the NTS system operation activity);
- e. Special Condition C8B (Restriction of revenue in respect of the NTS transportation owner activity and the NTS system operator activity); and
- f. Special Condition C14 (Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the NTS transportation owner activity and the NTS system operation activity);

and by introducing the following new condition:

- g. Special Condition C18 (Licensee's methodology for determining incremental exit capacity volumes).

41. A copy of the proposed modifications to the Original Transco Licence listed in paragraph 40 above can be found in Appendix 7C.

42. In each of the IDN Additional Licences and the RDN Additional Transco Licence by substituting for existing conditions:

- a. Special Condition E2A (Revenue restriction definitions in respect of the Distribution Network);
- b. Special Condition E2B (Restriction of revenue in respect of the Distribution Network transportation activity); and
- c. Special Condition E6 (Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the Distribution Network)

the following new conditions

- d. Special Condition E2A (Revenue restriction definitions in respect of the Distribution Network);
- e. Special Condition E2B (Restriction of revenue in respect of the Distribution Network transportation activity); and
- f. Special Condition E6 (Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the Distribution Network).

43. A copy of the proposed modifications to each of the IDN Additional Licences and the RDN Additional Transco Licence listed in paragraph 42 above can be found in Appendix 7E.

44. For the avoidance of doubt, it should be noted that the proposed modifications in Appendix 7E are not identical and each of the IDN Additional Licences and the RDN Additional Transco Licence will not have these Special Conditions amended in the same way. Accordingly Appendix 7E is in five parts referring to each of the relevant licences as set out in paragraph 35 above.

Reasons for proposed modifications in Part 2

45. The reasons why the Authority is proposing to make the modifications contained in Part 2 of this Notice to the Six Licences and their effects are set out in the documents listed in Annex 1 to this Notice and the consultation document which accompanies this Notice.

Summary of the effect of proposed modifications in Part 2

46. In summary, the effect of the proposed licence modifications set out in Part 2 of this Notice is to introduce interim incentive arrangements in each of the Six Licences and to effect changes to the price control conditions in each of the Six Licences to capture issues raised as part of the consultation process associated with the S8AA Notice and the second S23 Notice to ensure that customers' interests are protected in a divested industry structure. The proposed

modifications and their effects are discussed and explained in the explanatory document which accompanies this Notice¹³.

47. The modifications contained in Part 2 of this Notice, if made, would take effect on such date as the Authority may specify in writing which, for the avoidance of doubt, may not be the same date as the modifications contained in Part 1 of this Notice.

Documents

48. Copies of the proposed licence modifications are attached to this Notice. In order to address requests from respondents to previous consultations and due to the fact that substantial modifications to the Six Licences as a result of the S.8AA Consent and Direction and the Second S.23 Direction were made on 25 April 2005 and have not yet been brought into effect, all of the Standard Special Conditions and Special Conditions of the Six Licences have been attached in Appendix 7 and not just those conditions which this Notice proposes to modify. 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

Representations and objections

49. Any representations or objections with respect to the proposed modifications to the Six Licences must be made before 5.00pm on Tuesday 24 May 2005 and should be addressed to:

Sonia Brown

Ofgem

9 Millbank

London

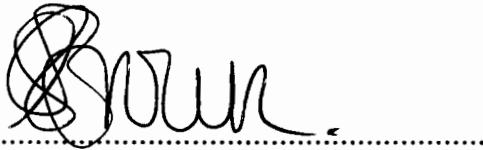
SW1P 3GE

Email: Helen.connolly@ofgem.gov.uk

¹³National Grid Transco – Potential sale of gas distribution network businesses. Final Proposals for Interim Incentives and Formal consultation under section 23 of the Gas Act 1986 – April 2005

50. 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.

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

A handwritten signature in black ink, appearing to read 'Sonia Brown', written over a horizontal dotted line.

Sonia Brown

Director, Transportation

Duly authorised on behalf of the Authority

26 April 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 Six Licences and their effects are set out in the following documents:

- 1.1 *National Grid Transco – Potential sale of gas distribution network businesses. Final Proposals for Interim Incentives and Formal consultation under section 23 of the Gas Act 1986 – April 2005;*
- 1.2 *Open Letter – Consent to NGT’s sale of four of its gas distribution networks – April 2005;*
- 1.3 *Urgent Modification Proposal 0745 – Modification of the Network Code into Transco plc’s individual (short form) network code – April 2005;*
- 1.4 *Consent to transfer four of the gas transporters licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986 – April 2005;*
- 1.5 *Modification to two of the six gas transporters licences held by Transco plc – direction pursuant to section 23 of the Gas Act 1986 – April 2005;*
- 1.6 *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;*
- 1.7 *Notice of proposed consent to transfer the four Additional 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 – April 2005;*
- 1.8 *National Grid Transco – Sale of gas distribution networks. Authority Decision. Transco plc applications to dispose of four gas distribution networks;*
- 1.9 *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;*

- 1.10 *DN Sales: Open Letter to Transco regarding credit cover arrangements for gas transportation use of system and connection charges 17 December 2004;*
- 1.11 *Erratum to Final Impact Assessments 2 December 2004;*
- 1.12 *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 – November 2004;*
- 1.13 *National Grid Transco – Potential Sale of Gas distribution network businesses – Final Impact Assessment – November 2004;*
- 1.14 *National Grid Transco – Potential sale of gas distribution network businesses – Final Impact assessment – Appendices – November 2004;*
- 1.15 *Transco plc – Form of five new additional GT licences granted to Transco plc on 5 November 2004 – 5 November 2004;*
- 1.16 *Transco plc – Notice of the grant of five new additional gas transporter licences – 5 November 2004;*
- 1.17 *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;*
- 1.18 *DN Sales: Ofgem note on initial draft of private CLM licence condition – 19 October 2004;*
- 1.19 *Open letter: updated timetable for potential gas distribution network sales project – 15 October 2004 – 238/04;*
- 1.20 *DN Sales: Gas distribution price controls further clarification – 6 October 2004;*
- 1.21 *DN Sales: National Grid Transco – potential sale of gas distribution network businesses – publication of NGT’s initial drafting of proposed new NTS/DN GT licences – 15 September 2004;*

- 1.22 *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;*
- 1.23 *Open letter on Special Condition 18 – 26 August 2004;*
- 1.24 *Ofgem preliminary position on business separation requirements to apply between distribution networks – 20 August 2004;*
- 1.25 *Offtake arrangements, conclusions document on framework – 13 August 2004 – 199/04;*
- 1.26 *Interruptions arrangements: conclusions on document framework – 13 August 2004 – 198/04;*
- 1.27 *DN Sales: open letter to NGT, potential DN purchasers and other parties on licence amendment process – 5 August 2004;*
- 1.28 *DN Sales: Ofgem position paper on pensions – 2 August 2004;*
- 1.29 *DN Sales: Open letter on environmental liabilities – 23 July 2004;*
- 1.30 *Transco plc – Notice of proposed grant and proposed modification of 8 new additional gas transporters licences – 22 July 2004;*
- 1.31 *Open letter: timetable for potential gas distribution network sales project – 16 July 2004;*
- 1.32 *National Grid Transco – potential sale of gas distribution network businesses. Interruptions arrangements: regulatory impact assessment. 30 June 2004 - 146/04;*
- 1.33 *National Grid Transco – potential sale of gas distribution network businesses. Offtake arrangements. Regulatory impact assessment. 11 June 2004 - 131/04;*
- 1.34 *National Grid Transco – potential sale of network distribution businesses Agency and governance arrangements – 28 May 2004 120/04;*
- 1.35 *National Grid Transco – potential sale of network distribution businesses. Allocation of roles and responsibilities between transmission and distribution network – 28 May 2004 – 119/04s;*

- 1.36 *DN Sales: RIA on options for exit reform industry letter – 20 May 2004;*
 - 1.37 *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;*
 - 1.38 *National Grid Transco – potential sale of network distribution businesses. Agency and governance arrangements: regulatory impact assessment. 20 April 2004 – 83/04;*
 - 1.39 *Open letter on Gas Distribution Price Controls – 16 March 2004;*
 - 1.40 *National Grid Transco – potential sale of network distribution businesses: next steps. 17 December 2003 – 170/03; and*
 - 1.41 *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).