

Shippers, National Grid Transco  
and other interested parties

29 April 2005

Dear Colleague,

**Ofgem – Final approval for hive-down of NGT's gas distribution networks**

On 25 April 2005, the Gas and Electricity Markets Authority (Authority) issued an open letter indicating that the conditions precedent attached to the Authority's consent<sup>1</sup> to hive-down four gas distribution networks (DNs) from Transco plc (Transco)<sup>2</sup> to four wholly owned Transco subsidiary companies (the four relevant wholly owned Transco subsidiary companies) had been sufficiently satisfied to allow Transco to take steps towards hive-down occurring on 1 May 2005.<sup>3</sup>

The Authority also set out that final consent to undertake hive-down would not be given until it has issued a further notice setting out that the conditions precedent had been satisfied in full and attaching the Implementation Directions necessary for hive-down to take place.

Subsequently, Ofgem wrote to Transco on 27 April 2005 requesting that Transco provide it with a hive-down report which, amongst other things, sets out Transco's views on its compliance with the conditions precedent (in the terms of the Authority's Consent Directions)<sup>4</sup>. Ofgem has now received Transco's response which indicates that all conditions precedent have been or will be satisfied by 1 May 2005.<sup>5</sup>

Having reviewed Transco's response and having due regard to its principal objective and statutory and other public law duties, and having carefully considered representations and objections received in respect of the various related consultations, the Authority has concluded that the conditions precedent have been or will be fully satisfied by 1 May 2005

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<sup>1</sup> The conditions precedent are described in Appendix 2 of the Authority's Consent Directions. *National Grid Transco – Sale of gas distribution networks: Transco plc applications to dispose of four gas distribution networks Authority decision*, 1 February 2005, 21/05. (the "Consent Directions") Appendix 2.

<sup>2</sup> Transco plc is a wholly owned subsidiary of National Grid Transco plc (NGT).

<sup>3</sup> 'Ofgem approves next stage of NGT's sale of four of its gas distribution networks', Ofgem, 25 April 2005.

<sup>4</sup> 'Gas distribution network sales – Request for final confirmation that the conditions precedent to the Authority's conditional consent have been met', Ofgem letter, 27 April 2005.

<sup>5</sup> 'Hive-Down Report, Letter from Transco to Ofgem, 29 April 2005.

and that Transco can now proceed to hive-down its four relevant DN businesses into its four relevant wholly owned Transco subsidiary companies on 1 May 2005.

The purpose of this letter is to set out the reasons for the Authority's decision and to outline the way forward with respect to DN sales.

## **Background**

The following section describes Ofgem's letter on the conditions precedent and Transco's response to this letter.

### *Ofgem letter*

Ofgem wrote to Transco on 27 April 2005 requesting that Transco provide it with a hive-down report which, amongst other things, sets out Transco's views on compliance with the conditions precedent including, without limitation, progress against the condition precedent relating to consents and approvals, namely paragraph 21(k) of the Authority's Consent Directions and the condition relating to the Health and Safety Executive's approval of Transco's safety cases, namely paragraph 21(e) of the Authority's Consent Directions.<sup>6</sup>

In its letter, Ofgem also requested that Transco consider whether there had been any material change in circumstances with respect to compliance with the conditions precedent which should be drawn to the attention of the Authority.

The letter also asked Transco for an update regarding the readiness of UK-Link and supporting systems to operate in a post hive-down environment.

### *Transco's response*

Transco responded to Ofgem's letter today<sup>7</sup>. In its letter, which is attached (as Annex 1) Transco updates its letter to Ofgem of 18 April 2005 and confirms that, in its view, the requirements of all of the conditions precedent have been or will be satisfied in full on 1 May 2005.

In its letter, Transco also states that there have been no material changes in circumstances since it issued its update letter to Ofgem of 18 April 2005 that should be brought to the attention of the Authority for consideration when it decides whether hive-down should be allowed to proceed on 1 May 2005.

The letter also confirms that Transco (in respect of the NTS and retained DNs (RDNs)) and its four relevant wholly owned Transco subsidiary companies expect to be in full compliance with their respective licences on 1 May 2005.

With respect to the paragraphs 21(e) and 21(k) of the conditions precedent, Transco indicated that:

- ◆ the Health and Safety Executive (HSE) has accepted the Transco Safety Case, in respect of the Transco NTS and RDN businesses along with the four independent DN (IDN)

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<sup>6</sup> *Gas distribution network sales – Request for final written confirmation once conditions precedent of the Authority's consent directions have been fully satisfied*, Ofgem, 27 April 2005.

<sup>7</sup> *'Hive-Down Report'*, Transco letter to Ofgem, 29 April 2005.

Safety Cases. Transco also stated that the HSE accepted the Safety Case for the Scottish Independent Undertakings (SIUs). In addition, Transco has confirmed that there are no outstanding health and safety issues associated with allowing hive-down to take place. On this basis Transco indicated that it had fully satisfied the requirements of the condition precedent contained in paragraph 21(e) of the Authority's Consent Directions; and

- ◆ it had identified all of the consents and approvals necessary to ensure Transco's full compliance with its NTS and RDN licences and each relevant wholly owned subsidiary company's full compliance with its respective IDN licence. In this respect, Transco also acknowledged that it was responsible for the identification of the consents and approvals required to ensure compliance with the six licences and that it has sought to ensure all necessary consents and approvals have been requested and put in place to ensure full compliance with these licences from 1 May 2005 (or any other later date the Authority may direct). Transco indicated that Ofgem had written to it today indicating that the Authority will grant all necessary consents and approvals which Transco has identified as necessary in respect of the proposed hive-down with effect from 1 May 2005 thereby fully satisfying the conditions precedent contained in paragraph 21(k) of the Authority's Consent Directions.

In terms of paragraph 21(d) of the Consent Directions, Transco has confirmed that it has procured agreement from shippers and each of its four relevant subsidiary companies to each of the short form network codes in respect of its IDNs. Transco indicates in its letter that the arrangements in respect of industry codes will create a new robust contractual framework fully capable of supporting a divested industry structure and are consistent with the Authority's decisions associated with network sales.

Transco states that the Uniform Network Code (UNC) in its current form will enable the Transco NTS, and RDN businesses and the four relevant wholly owned Transco subsidiary companies to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives set out in Standard Special Condition A11(1) of their respective gas transporter (GT) licences.

Transco also confirms that arrangements have been implemented such that the Joint Office will be operational from 1 May 2005 allowing GTs to discharge their obligations set out in Standard Special Condition A12 of their respective GT licences.

In its letter, Transco also confirms that there are no issues or impediments associated with the readiness of UK-Link and supporting systems for proceeding to hive-down on 1 May 2005.

### **Authority's view**

Having regard to Transco's response, the Authority has now concluded that, other than with respect to the matters discussed below, there have been no material changes in circumstances since the release of its decision on 25 April 2005 with respect to compliance with the conditions precedent that would necessitate the Authority altering its view on the satisfaction of these conditions.

In the following section, the Authority sets out its view on each specific condition precedent set out in its Consent Directions.

#### *Licence modification conditions*

As noted in its letter of 25 April 2005, the Authority considers that the condition precedent set out in paragraph 21(a) of the Consent Directions has been fully satisfied.

In addition, the Authority considers that the conditions precedent set out in paragraph 21(b) of the Consent Directions will be satisfied on 1 May 2005 when the relevant modifications to Transco's licences (in respect of its NTS, RDN and IDN businesses) are directed to take effect in accordance with the Implementation Directions (discussed further below).

The Authority also notes Transco's view that the licences that will be in place at hive down in respect of the NTS, RDNs and IDNs are robust and appropriate to support a multi-transporter industry structure and will provide a regulatory framework that will ensure customers' interests are protected.

#### *Licence transfer condition*

The Authority considers that the condition precedent set out in paragraph 21(c) of the Consent Directions will be satisfied on 1 May 2005 when the four GT licences in respect of the four relevant DN businesses are to be transferred from Transco to its four relevant wholly owned subsidiary companies in accordance with the Implementation Directions.

#### *Industry codes condition*

As noted in its letter of 25 April 2005, the Authority formed the view that the condition precedent regarding industry codes has been sufficiently satisfied to permit Transco to take the necessary steps towards proceeding to hive-down.

Having reviewed Transco's letter of today, the Authority notes Transco's view that it considers that the code arrangements are appropriate and sufficiently robust to support a multi-transporter commercial framework under a divested industry structure. Having regard to (amongst other things) these assurances, the Authority is satisfied that condition precedent set out in paragraph 21(d) will be satisfied on 1 May 2005.

#### *HSE condition*

The Authority considers that the condition precedent set out in paragraph 21(e) of the Consent Directions has been fully satisfied as Transco has received all safety cases in respect of each of the four relevant wholly owned subsidiary companies as well as its NTS business and its RDN business. In this respect, the Authority has obtained confirmation from the HSE that it has now accepted the Safety Cases of NTS and DN businesses as well as the Safety Cases in respect of the Scottish Independent Undertakings.

#### *The Secretary of State conditions*

As noted in its letter of 25 April 2005, the Authority considers that the conditions precedent set out in paragraphs 21(f) and 21(g) of the Consent Directions have been fully satisfied.

#### *The provision of undertakings conditions*

As noted in its letter of 25 April 2005, the Authority considers that the conditions precedent set out in paragraphs 21(h) and 21(i) of the Consent Directions have been fully satisfied.

### *Consistency of IDN hive-down with licence conditions*

As noted in its letter of 25 April 2005, the Authority considers that the condition precedent set out in paragraph 21(j) of the Consent Directions has been fully satisfied.

### *Consents and approvals condition*

In relation to paragraph 21(k) of the Consent Directions concerning consents and approvals, the Authority has today issued a letter to Transco listing the consents and approvals that it is minded to grant Transco from 6am on 1 May 2005. A copy of the letter and schedule of consents that the Authority is minded to grant was published today and can be found on Ofgem's website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Whilst, these consents have therefore not been unconditionally obtained as of today, the Authority nevertheless is satisfied that as of 1 May 2005 this will be the case and, as such, all necessary consents as identified by Transco will be in place. As such, the Authority considers that the conditions precedent set out in paragraph 21(k) of the Consent Directions will be satisfied by 1 May 2005.

In reaching this conclusion, the Authority has had regard to (amongst other things) the assurances provided by Transco that it is responsible for identifying all of the consents and approvals that it requires and that, in this context (and without limitation), it has sought to ensure that all the necessary approvals and consents have been requested and put in place to ensure full compliance with the relevant licences from 1 May 2005.

### *Systems issues*

Based on the assurances contained in Transco's letter the Authority is satisfied that there are no issues or impediments associated with the readiness of UK-Link and supporting systems for proceeding to hive-down on 1 May 2005.

### *Conclusion*

For the reasons set out in this letter and having due regard to its principal objective and statutory and other public law duties, and having carefully considered representations and objections received in respect of the various related consultations, the Authority has concluded that the relevant conditions precedent have been fully satisfied (or will be fully satisfied on 1 May 2005) and that Transco can now proceed to hive-down its four DN businesses into its four wholly owned subsidiary companies at 6am (BST) on Sunday 1 May 2005.

This letter therefore serves as the Authority's confirmation that the conditions precedent have been satisfied in full (or will be satisfied on 1 May 2005) and attaches the Implementation Directions (as Annexes 1 and 2 respectively) which are discussed further below.

### **Implementation of hive-down**

On the basis of its decision on the conditions precedent to hive-down, the Authority has today issued two Implementation Directions that:

- ◆ direct the implementation of the relevant modifications to the four licences in respect of the IDN businesses under section 8AA<sup>8</sup> of the Gas Act to take effect at 6am on Sunday 1 May 2005;<sup>9</sup>
- ◆ direct the relevant modifications to Transco's two licences in respect of its NTS and RDN businesses under section 23<sup>10</sup> of the Gas Act to take effect from 6am on Sunday 1 May 2005;<sup>11</sup>
- ◆ direct the implementation of Urgent Modification Proposal 0745<sup>12</sup> from 6am Sunday 1 May 2005;
- ◆ designate the four short form codes for each of the four IDNs from 6am Sunday 1 May 2005; and
- ◆ formally consent to the transfer of the four licences (relating to the four IDNs) from Transco to its four relevant wholly owned subsidiary companies occurring at 6am on Sunday 1 May 2005.

It should be noted that the changes will take effect in the sequence set out in the Implementation Directions. Copies of the two Implementation Directions are attached to this letter as Annex 3.

## Way forward

### *Conditions subsequent*

Under NGT's commercial timetable for DN sales, at the time that hive-down is expected to complete, the regulatory, commercial and operational framework necessary to protect the interests of customers under a divested industry structure will not be fully in place. Further it was considered necessary for the Authority to retain control over share sale given that other issues may arise through the detailed development of the regulatory, commercial and operational framework that have not yet been anticipated or addressed. As such, paragraph 23(b) of the Authority's Consent Directions stipulated that Transco cannot, after hive-down has occurred, dispose of the shares in the four relevant wholly owned subsidiary companies without the Authority's prior consent.

Accordingly, and without fettering the discretion of the Authority in future decisions, the Authority will need to consider whether it is willing to consent to the sale of shares in Transco's four relevant wholly owned subsidiary companies to the three potential third party purchasers. Any such approval will be subject to the fulfilment of the conditions subsequent to the consent granted in January 2005, set out in paragraph 23(c) of the Consent Directions, which will be considered by the Authority following hive-down.

Under the condition subsequent contained in paragraph 23(c) of the Consent Directions, the Authority has retained discretion to require subsequent licence modifications or the

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<sup>8</sup> *Consent to transfer four of the GT licences held by Transco plc incorporating a direction pursuant to section 8AA of the Gas Act 1986*, Ofgem, 25 April 2005.

<sup>9</sup> It is noted that these modifications were made on 25 April but had not been given effect.

<sup>10</sup> *Modification to two of the six GT licences held by Transco plc -direction pursuant to section 23 of the Gas Act 1986*, Ofgem, 25 April 2005.

<sup>11</sup> It is noted that these modifications were made on 25 April but had not been given effect.

<sup>12</sup> *Urgent Modification Proposal 0745 "Modification of the Network Code into Transco's individual (Short Form) Network Code"*, Ofgem decision letter, 25 April 2005.

implementation of such other regulatory, commercial or operational arrangements before the conditions subsequent, attached to its consent to hive-down, will be deemed to have been satisfied, thereby allowing sale of the shares in the four relevant wholly owned subsidiary companies to third party purchasers.

#### *Section 23 licence consultation*

The condition subsequent contained in paragraph 23(c) of the Consent Direction states that Transco will need to provide its consent, and procure that each of its four relevant wholly owned subsidiary companies provide their consent, to any licence modifications which the Authority may require following hive-down in order to ensure that customers interested are protected in a divested industry structure.

In this respect, on 26 April 2005 Ofgem issued a further section 23 licence modification consultation in relation to each of the six relevant licences relating to the NTS and DN interim incentives to apply until 30 September 2008.<sup>13</sup> The section 23 notice also consults upon additional modifications to the NTS, IDN and RDN GT licences necessary to protect the interests of customers in a divested industry structure.

Subject to consideration of views expressed by respondents, the Authority expects to direct the changes included within this section 23 notice to take effect from 1 June 2005, the proposed date of share sale. Prior to this date, the Authority will issue a letter to Transco requesting its view on the progress it has made towards satisfying the conditions subsequent. The Authority will then issue an open letter to Transco stating whether it considers that the conditions subsequent have been satisfied and therefore whether the sale of shares in the four relevant wholly owned Transco subsidiary companies to the prospective third party purchasers can proceed.

#### *Additional requirement*

As noted in Ofgem's letter of 25 April 2005, the Authority has determined that an additional requirement should be introduced (without limitation) under the condition subsequent contained in paragraph 23(c) of the Authority's Consent Directions to ensure that customers' interests can be protected in a divested industry structure. This additional requirement will need to be satisfied before the Authority will allow share sale to proceed. The purpose of this additional requirement is to ensure that, overall, customers do not bear any of the costs associated with the unconstrained incremental release of NTS offtake flexibility for the interim period.

This letter serves as formal notice to Transco of the additional requirement under the condition subsequent contained in paragraph 23(c) of the Authority's Consent Directions which is set out as follows:

**Transco shall (and whilst it is the legal or beneficial owner of the share capital of the four relevant wholly owned subsidiary companies, shall procure that each such company shall), prior to the sale of the shares in the four relevant wholly owned subsidiary companies, enter into arrangements (in a form approved in writing by the Authority) with both the retained distribution networks, and each of the four relevant wholly owned subsidiary companies, to ensure that customers do not bear any of the costs associated with the unconstrained incremental release of National Transmission System offtake flexibility, such arrangements are to continue until**

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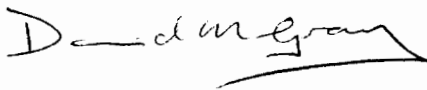
<sup>13</sup> *National Grid Transco – Potential Sale of gas distribution network businesses, Final Proposals for interim incentives and formal consultation under section 23 of the Gas Act 1986, Ofgem, April 2005.*

**such time as National Transmission System offtake (flexibility) capacity is first released pursuant to the enduring offtake arrangements or such other date as the Authority may specify in writing.**

For the avoidance of doubt, nothing in this letter shall prevent the Authority from specifying further additional requirements pursuant to the condition subsequent contained in paragraph 23(c) of the Consent Direction.

If you have any questions about any of the issues addressed in this letter, please contact Sonia Brown (020 7901 7412) or Mark Feather (020 7901 7434), who would be happy to help.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'David Gray', with a horizontal line extending from the end of the signature.

David Gray  
**Managing Director, Networks Division**

Signed on behalf of the Authority and authorised for that purpose by the Authority