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29 April 2005

Dear Sonia

## Hive-Down Report

This hive-down report is provided in response to your letter of 27 April 2005 entitled “Gas Distribution Network Sales – Request for final written confirmation that the conditions precedent to the Authority’s conditional consent have been fully met”.

Transco’s final assessment of the extent to which each of the conditions precedent set out in the Authority’s consents to Network Sales issued in February 2005<sup>1</sup> (the “Authority’s Consent Directions”) has been met is detailed in the Appendix to this report. In summary, **Transco considers that all the conditions precedent to the Authority’s Consent Direction have been met in full** as described in the Appendix. Accordingly, subject to the Authority being satisfied with this assessment, Transco requests the Authority’s final permission, by way of implementation directions issued by the Authority, for Transco to implement hive-down at 06:00 hours BST on 1 May 2005.

To assist the Authority in reaching its decision, I would like to draw its attention to a number of areas where you sought specific views in your letter:

## Material Changes in Circumstances

Transco does not consider that there has been any material change in circumstances since my update letter of 18 April 2005<sup>2</sup> that should be brought to the Authority’s attention for consideration when it decides whether hive-down should be allowed to proceed on 1 May 2005.

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<sup>1</sup> NGT – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks, Decision document Ofgem, February 2005 21/05, Appendix 2

<sup>2</sup> Update on process regarding conditions precedent of the Authority’s consent directions, Chris Train to Sonia Brown, 18 April 2005

## **Licences**

Transco considers that the licences that will be in place at hive-down in respect of Transco's NTS and RDN activities, together with the licences in respect of the four Transco subsidiary IDNs are robust and appropriate to support a multi-transporter industry structure, and will provide a regulatory framework that will ensure that customer interests continue to be protected under this structure.

## **Consent and Approvals**

Paragraph 21(k) of the Authority's Consent Directions requires that "Any other consent; clearance, permission, authorisation or approval required under statute, the Original Transco Licence or otherwise in respect of the proposed hive-down of the IDNs from Transco to each of the four relevant wholly owned Transco subsidiary companies (Blackwater F Limited, Blackwater G Limited, Blackwater SC A Limited, and Blackwater 2 Limited) having been unconditionally obtained."

Transco notes and agrees to the blanket revocation of consents, approvals, etc ("licence-related instruments" ("LRIs")) issued in respect of the Original Transco Licence ("existing LRIs"), subject to a number of specified exclusions. We understand that this revocation will take effect on 1 May 2005 (or any other later date the Authority may direct).

Furthermore, Transco has identified all the LRIs necessary to ensure Transco's full compliance with the modified Original Transco Licence (in respect of the NTS), Transco's full compliance with the modified Additional Transco Licence (in respect of the RDNs), and each Transco IDN subsidiary company's compliance with the Additional Transco Licence that will be modified and transferred to it, where all such modifications and transfers will come into effect on 1 May 2005 (or any other later date the Authority may direct) ("new LRIs"). The complete list of new LRIs necessary to ensure compliance with these licences from 1 May 2005 (or any other later date the Authority may direct), together with a list of existing LRIs to be excluded from the blanket revocation, was provided by Transco to Ofgem on 28 April 2005.

Ofgem has written to Transco today indicating that the Authority is minded to grant the new LRIs requested such that they will come into force on 1 May 2005 (or any other later date the Authority may direct). Accordingly, Transco considers that once Transco's existing LRIs have been revoked, and the new LRIs requested have come into force, the condition set out in paragraph 21(k) of the Authority's Consent Directions will have been met.

Transco acknowledge that the process for identifying all the necessary LRIs required to ensure compliance with the six licences described above is Transco's responsibility, and has sought to ensure that all the necessary LRIs have been requested to ensure full compliance with these licences from 1 May 2005 (or any other later date the Authority may direct).

## **Network Code Arrangements**

Transco consider the latest UNC, as provided to Ofgem on 25 April 2005, to be appropriate and sufficiently robust to support a multi-transporter commercial framework under a divested industry structure. We also consider that the UNC in this form will enable all relevant prospective GT licensees (Transco NTS, Transco RDN, and each prospective

IDN) 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 GT licences. Furthermore, we consider the UNC to be consistent with all relevant Authority decisions associated with network sales. Accordingly, we consider paragraph 21(d) to the Authority's Consent Directions in respect of the UNC to have been met.

In its decision document published on 25 April 2005 on Network Code Modification Proposal 0745<sup>3</sup>, the Authority determined that the proposal better facilitates the relevant objectives of Transco's Original Licence as set out in Amended Standard Condition 9, and directed the implementation of the proposal to take effect on 1 May 2005 (or any other later date the Authority may direct). This will effectively create Transco's individual 'short-form' Network Code, incorporating by reference the Uniform Network Code, thus ensuring continuity in provision of transportation arrangements to Users on the NTS and Transco's RDNs. The Authority also designated for each of the IDNs an individual 'short-form' Network Code identical in all but name to Transco's individual 'short-form' Network Code.

Users were invited to sign, during the course of this week, new framework agreements with each IDN, thus ensuring the contractual provision of transportation arrangements to Users of each new IDN under the terms of each IDN's individual 'short-form' Network Code, which incorporates, by reference, the provisions of the UNC.

Transco can now confirm that all Users requiring transportation arrangements on one or more of the IDNs have now signed the relevant framework agreement(s), thus ensuring the provision of transportation arrangement to Users of the four IDNs from the 1 May 2005 (or any other later date the Authority may direct). Rules set out within the UNC Transition Document will ensure continuity in the provision of transportation arrangements to Users of these networks during the transition from the existing Transco Network Code arrangements to the new UNC-based commercial framework.

Accordingly, arrangements in respect of industry codes, and in particular the UNC, will be fully established on 1 May 2005 (or any other later date the Authority may direct), thus creating the new, robust contractual framework fully capable of supporting a divested industry structure. Transco therefore considers that the conditions set out in paragraph 21(d) to the Authority's Consent Directions in relation to network code arrangements to have been met in full.

### **Health and Safety Approvals**

The Health and Safety Executive has accepted Safety Cases version 4.1, which facilitate hive-down, and which comprise the Transco Safety Case (Transco NTS and Transco RDNs) along with the four IDN Safety Cases. The HSE accepted the Scottish Independent Undertakings (SIU) Safety Case version 4 on 27 April 2005; this was outstanding in my update letter of 18 April 2005. Accordingly, we now consider that the condition set out in paragraph 21(e) to the Authority's Consent Directions has been met in full. Transco can confirm that there are no outstanding issues with the HSE that would prevent hivedown occurring on 1 May 2005.

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<sup>3</sup> 125/05 - Urgent Modification Proposal 0745 - Modification of the Network Code into Transco's individual (short form) network code

## **Readiness of UK-Link and Supporting Systems**

All key components required to establish xoserve as a separate service provision company are in place to allow xoserve to go-live as the Agency for all relevant transportation networks from 1<sup>st</sup> May 2005 under the terms of their GT licence condition SSC A15. Transco believes these arrangements will support a smooth transition to the new multi-transporter environment. The operation and management of the UK Link suite of systems is a fundamental part of such services.

The current position with respect to the changes to UK-Link and its supporting systems that are required to facilitate a multi-transporter environment is as follows. Changes supporting multiple transporters have been successfully implemented to Conquest, the Internet Access to Data service, M-number database and the related Information reporting systems. All remaining UK-Link system changes continue to proceed to plan, and the last stage of regression testing has been completed which means we are ready to implement.

xoserve, on behalf of Transco, is continuing to provide support to shipper system testing activities. From xoserve's discussions with operational contacts within shipper organisations, Transco are fully confident that shippers' systems will be ready to operate in a post-DN-sales environment, such that multi-transporter invoicing can commence in June in respect of charges incurred during May, with the first batch of invoices issued in respect of the separate relevant transporters on 6 June 2005. These are the only changes to UK Link systems that are required to support DN sales.

## **Other Issues – Joint Office arrangements**

Transco can confirm that arrangements have been put in hand such that the Joint Office will be operational from 1 May 2005, allowing the GTs to discharge their obligations as set out in Standard Special Condition A12 of their respective GT Licences.

## **Summary**

Transco is satisfied that all the conditions precedent set out in the Authority's Consent Directions will be met in full on 1 May 2005 (being the date envisaged to be specified within the Section 8AA and Section 23 implementation directions), with the implementation of Network Code Modification Proposal 0745 which will establish the UNC arrangements and facilitate the creation of a multi-GT commercial framework, together with the direction of the 8AA and S23 licence modifications that will facilitate the creation of a multi-transporter regulatory framework.

I can also confirm that with the issue of the new LRIs identified by Transco in its letter to Ofgem on 28 April 2005, Transco (in respect of the NTS and RDNs) and its four IDN subsidiaries expect to be in full compliance with their respective licences on 1 May 2005<sup>4</sup>.

Accordingly, subject to the Authority being satisfied with this assessment, Transco requests the Authority to issue the relevant implementation directions (thereby causing the

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<sup>4</sup> Subject to the relevant licensees taking all reasonable steps to satisfy any conditions that might be attached to the LRIs that are issued.

conditions precedent to be met in full on 1 May 2005) and grant its final permission to allow Transco to undertake hive-down at 06:00 hours BST on 1 May 2005.

If you wish to discuss any of the issues raised in this report, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Train', with a stylized, cursive script.

Chris Train

Director – Network Sales

## **APPENDIX**

### **Update on status with respect to the conditions precedent to Ofgem's consent to Network Sales as set out in the Direction published on 31 January 2005<sup>5</sup>**

The conditions precedent to the Authority's consent to Network Sales are set out below, together with, in bold text, the current status with respect to satisfying these conditions:

#### ***Conditions precedent***

The consent of the Authority set out in the Direction published on 31 January 2005 is in all respects conditional upon and shall not in any way become effective unless and until:

- (a) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the proposed modifications to each of the Transco Licences as largely set out in the Initial S23 Modifications notice relating to the separation of the price controls and such licence modifications having become effective;

**Transco provided written consent to the modifications to each of the six Transco Licences as largely set out set out in the Initial S23 Modification notice relating to the separation of price controls on 31 January 2005, with the Authority (not having received a direction from the Secretary of State not to make any modification) directing the modifications on 1 February 2005, to come into effect on that date. Accordingly, Transco considers this condition to have been met in full.**

- (b) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the S8AA Modifications to each of the four relevant Additional Transco Licences (which Transco envisages will at the relevant time relate to each of the four IDNs respectively only) and the Second S23 Modifications to the Original Transco Licence (which Transco envisages will at the relevant time relate to the NTS only) and the one relevant Additional Transco Licence (which Transco envisages will at the relevant time relate to the four RDNs only) and in each case such licence modifications having become effective;

**On 25 April 2005, Transco provided its written consent to the Authority in respect of the modifications to the four Additional Transco Licences (which will at the relevant time relate to each of the four IDNs respectively) as set out in the Direction incorporated within the Authority consent to the transfer of these licences issued by the Authority on 25 April 2005<sup>6</sup>, to take effect on 1 May 2005 (or any other later date the Authority may direct) pursuant to the**

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<sup>5</sup> NGT – Sale of gas distribution networks: Authority decision – Transco plc applications to dispose of four gas distribution networks, Decision document Ofgem, February 2005 21/05, Appendix 2.

<sup>6</sup> 126/05 - 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

**Section 8AA implementation direction anticipated to be made by the Authority on 29 April 2005.**

**Furthermore, on 25 April 2005, Transco provided written consent to the Authority in respect of the modifications to the Original Transco Licence (in relation to the NTS) and the relevant Additional Transco Licence (in relation to the four RDNs) as set out in the Direction issued by the Authority on 25 April 2005<sup>7</sup>, to take effect on 1 May 2005 (or any other later date the Authority may direct).**

**Transco considers that the licences that will be in place at hive-down in respect of Transco's NTS and RDN activities, together with the licences in respect of the four Transco subsidiary IDNs are robust and appropriate to support a multi-transporter industry structure, and will provide a regulatory framework that will ensure that customer interests continue to be protected going forward under this structure.**

**Transco considers that this condition has therefore been met as fully as is possible prior to 1 May 2005 (or any other later date the Authority may direct), and sufficiently to proceed to hive-down on 1 May 2005. Transco now requests the Authority to issue the relevant implementation directions confirming that these licence modifications will take effect on 1 May 2005, thereby causing this condition to have been met in full.**

- (c) The Authority having consented (pursuant to Section 8AA of the Act) in writing to the transfer of the each of four Additional Transco Licences each of which Transco envisages will at the relevant time relate to one of the four IDNs respectively only and Transco having actually transferred one of those licences to each of Transco's four relevant wholly owned subsidiaries (one of which is the Company) respectively in accordance with the Authority's consent;

**Pursuant to the section 8AA consent and direction issued by the Authority on 25 April 2005, and the relevant implementation direction which is envisaged will be given on 29 April 2005 by the Authority, Transco will transfer the four Additional Transco Licences (in respect of the four IDNs) to the four relevant wholly owned subsidiaries on 1 May 2005 (or any other later date the Authority may direct), thereby causing this condition to have been met in full.**

- (d) The Authority being satisfied as to the proposed arrangements as part of the Proposed Transaction for industry codes, including without limitation the UNC and various network codes and (again without limitation) the Authority having directed the Transco Network Code Modification Proposal to be implemented as it better facilitates the relevant code objectives (as defined in the Original Transco Licence) and consequently the modifications to the Transco Network Code having become effective;

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<sup>7</sup> **127/05** - Modification to two of the six gas transporters licences held by Transco plc - Direction pursuant to section 23 of the Gas Act 1986, Ofgem, 25 April 2005

Transco consider the latest UNC, as provided to Ofgem on 25 April 2005, to be appropriate and sufficiently robust to support a multi-transporter commercial framework under a divested industry structure. We also consider that the UNC in this form will enable all relevant prospective GT licensees (Transco NTS, Transco RDN, and each prospective IDN) to have in place transportation arrangements that will enable them to facilitate the achievement of the relevant objectives as set out in Standard Special Condition A11(1) of their respective GT licences. Furthermore, we consider the UNC to be consistent with all relevant Authority decisions associated with network sales. Accordingly, we consider paragraph 21(d) to the Authority's Consent Directions in respect of the UNC to have been met.

In its decision document published on 25 April 2005 on Network Code Modification Proposal 0745<sup>8</sup>, the Authority determined that the proposal better facilitates the relevant objectives of Transco's Original Licence as set out in Amended Standard Condition 9, and directed the implementation of the proposal to take effect on 1 May 2005 (or any other later date the Authority may direct). This will effectively create Transco's individual 'short-form' Network Code, incorporating by reference the Uniform Network Code, thus ensuring continuity in provision of transportation arrangements to Users on the NTS and Transco's RDNs.

The Authority also designated for each of the IDNs an individual 'short-form' Network Code identical in all but name to Transco's individual 'short-form' Network Code.

Users were invited to sign, during the course of this week, new framework agreements with each IDN, thus ensuring the contractual provision of transportation arrangements to Users of each new IDN under the terms of each IDN's individual 'short-form' Network Code, which incorporates, by reference, the provisions of the UNC.

Transco can now confirm that all Users requiring transportation arrangements on one or more of the IDNs have now signed the relevant framework agreement(s), thus ensuring the provision of transportation arrangement to Users of the four IDNs from the 1 May 2005 (or any other later date the Authority may direct). Rules set out within the UNC Transition Document will ensure continuity in the provision of transportation arrangements to Users of these networks during the transition from the existing Transco Network Code arrangements to the new UNC-based commercial framework.

Accordingly, arrangements in respect of industry codes, and in particular the UNC, will be fully established on 1 May 2005 (or any other later date the Authority may direct), thus creating the new, robust contractual framework fully capable of supporting a divested industry structure.

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<sup>8</sup> 125/05 - Urgent Modification Proposal 0745 - Modification of the Network Code into Transco's individual (short form) network code



**Arrangements in respect of industry codes will therefore be fully established on 1 May 2005 (or any other later date the Authority may direct), thereby causing this condition to be met in full.**

- (e) The Health and Safety Executive having received safety cases in respect of each of Transco's four relevant wholly owned subsidiary companies (one of which is the Company) (for each of the four IDNs proposed to be hived-down to each one respectively (one of which is the Distribution Network Business)) and in respect of Transco (for the NTS and the RDNs) and each of those safety cases having been accepted by the Health and Safety Executive pursuant to the Gas Safety (Management) Regulations 1996;

**The Safety Cases version 4.1, which facilitate hive-down, and which comprise the Transco Safety Case (Transco NTS and Transco RDNs) along with the four IDN Safety Cases, were accepted by the Health and Safety Executive (HSE) on 15 April 2005. We can now confirm that the HSE accepted the Scottish Independent Undertakings (SIU) Safety Case version 4 on 27 April 2005. Accordingly, Transco considers this condition to have been met in full.**

- (f) The Secretary of State having granted her consent to the proposed hive-down of each of the four IDNs (one of which is the Distribution Network Business) pursuant to Amended Standard Condition 29 of the Original Transco Licence to each of the four relevant Transco wholly owned subsidiary companies (one of which is the Company) and such consents having unconditionally come into full effect;

**The Secretary of State granted her consent to the proposed disposals on 27 January 2005, and published a written ministerial statement<sup>9</sup> to this effect on 2 February 2005. Accordingly, Transco considers this condition to have been met in full.**

- (g) The Secretary of State in exercise of the powers conferred upon her by Section 6A of the Act having, in connection with the Proposed Transaction, made an Order granting an exemption to certain gas transporters in respect of certain gas shipping arrangements as described in the consultation document issued by the Department of Trade and Industry on 19 November 2004 and such Order coming into full force and effect;

**The Gas Act 1986 (Exemption) (No. 2) Order 2005 granting an exemption to certain gas transporters in respect of certain gas shipping arrangements was made on 5 February 2005 and laid before Parliament on 11 February 2005. It comes into full force and effect on 1 May 2005. Accordingly, Transco considers this condition to have been met in full.**

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<sup>9</sup> Written statement, Department of Trade and Industry, Sale of four National Grid Transco's Gas Distribution Networks - Regulatory Consents granted by the Secretary of State, 2 February 2005

- (h) Within seven days from the date of this Direction, Transco having procured from NGT an undertaking addressed to the Authority in the form specified by the Authority that NGT will:
- i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of NGT (including for the avoidance of doubt, Transco and its subsidiaries) will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
  - ii. from the date of such undertaking until the date on which the S8AA Modifications and the Second S23 Modifications become effective use its best endeavours to ensure that Transco and, during the period that Transco is the legal or beneficial owner of share capital of the four relevant wholly owned Transco subsidiary companies (one of which is the Company), each such subsidiary company (including the Company) takes steps to implement by 1 September 2005 the enduring offtake arrangements as described in the Authority's Final Impact Assessment in relation to the Proposed Transaction in November 2004<sup>10</sup> (the "Enduring Offtake Arrangements") in a format approved by the Authority;

**The required undertaking was provided by NGT to the Authority on 2 February 2005. Accordingly, Transco considers this condition to have been met in full.**

- (i) Within twenty eight days from the date of this Direction, Transco having procured from each of the Purchasers an undertaking addressed to the Authority in the form specified by the Authority that the Purchaser will:
- i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of the Purchaser will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
  - ii. from the date of such undertaking until the date on which the relevant Purchaser becomes (directly or indirectly) the legal or beneficial owner of the share capital of a relevant Transco subsidiary company (one of which is the Company), use its best endeavours to ensure that such company takes steps to implement by 1 September 2005 the Enduring Offtake Arrangements in a format approved by the Authority;

**The required undertakings were requested by NGT from the Purchasers following the Authority decision, and subsequently provided to the Authority within 28 days from the date of the Direction. Accordingly, Transco considers this condition to have been met in full.**

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<sup>10</sup> National Grid Transco – Potential sale of gas distribution network businesses. Final Impact Assessment. November 2004

- (j) The proposed hive-down of the IDNs (one of which is the Distribution Network Business) from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) being consistent with all applicable conditions contained in the Original Transco Licence; and

**Transco believes that the proposed hive-down of the IDNs is consistent with all applicable conditions contained in the Original Transco Licence. Accordingly, Transco considers this condition to have been met in full.**

- (k) Any other consent; clearance, permission, authorisation or approval required under statute, the Original Transco Licence or otherwise in respect of the proposed hive-down of the IDNs from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) having been unconditionally obtained.

**Transco notes and agrees to the blanket revocation of consents, approvals, etc (“licence-related instruments” (“LRIs”)) issued in respect of the Original Transco Licence (“existing LRIs”), subject to a number of specified exclusions. We understand that this revocation will take effect on 1 May 2005 (or any other later date the Authority may direct).**

**Furthermore, Transco has identified all the LRIs necessary to ensure Transco’s full compliance with the modified Original Transco Licence (in respect of the NTS), Transco’s full compliance with the modified Additional Transco Licence (in respect of the RDNs), and each Transco IDN subsidiary company’s compliance with the Additional Transco Licence that will be modified and transferred to it, where all such modifications and transfers will come into effect on 1 May 2005 (or any other later date the Authority may direct) (“new LRIs”). The complete list of new LRIs necessary to ensure compliance with these licences from 1 May 2005 (or any other later date the Authority may direct), together with a list of existing LRIs to be excluded from the blanket revocation, was provided by Transco to Ofgem on 28 April 2005.**

**Ofgem has written to Transco today indicating that the Authority is minded to grant the new LRIs we have requested such that they will come into force on 1 May 2005 (or any other later date the Authority may direct). Accordingly, Transco considers that once Transco’s existing LRIs have been revoked, and the new LRIs requested have come into force, the condition set out in paragraph 21(k) of the Authority’s Consent Directions will have been met.**

**Transco acknowledge that the process for identifying all the necessary LRIs required to ensure compliance with the six licences described above is Transco’s responsibility, and has sought to ensure that all the necessary LRIs have been requested to ensure full compliance with these licences from 1 May 2005 (or any other later date the Authority may direct).**

**Transco believes that no other such consent, clearance, permission, authorisation or approvals are required in respect of the proposed hive-down of the IDNs under statute, the Original Transco Licence or otherwise.**

Accordingly, Transco considers that, once the existing LRIs have been revoked and the new LRIs have come into force as described above, this condition will have been met in full.