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Dear Chris,

Gas Distribution Network Sales – Open letter to NGT, Transco and the DN companies requesting report relating to the Authority’s decision on conditions subsequent

As you are aware, on 20 January 2005, the Gas and Electricity Markets Authority (the Authority) attached a number of conditions precedent and conditions subsequent to its consent to Transco plc (Transco) to dispose of four of its gas distribution networks (DNs) to four wholly owned Transco subsidiary companies (the DN companies¹).² The conditional consent prohibited the disposal of the shares in these four relevant DN companies without the Authority’s further consent.

On 29 April 2005, the Authority concluded that the conditions precedent had been or would be fully satisfied by 1 May 2005 and therefore gave Transco consent to hive-down its four relevant DN businesses into the four DN companies on 1 May 2005.³ Hive down of the four relevant DNs to the relevant DN companies took place on that date.

The Authority is scheduled to consider whether the conditions subsequent have been satisfied next week and whether consent to sell the shares in the four DN companies to third party purchasers⁴ should be granted.⁵ If the Authority determines that the conditions subsequent have been satisfied then without fettering the Authority’s discretion, it is envisaged that Transco would be granted consent to sell the shares in the four DN companies to third party purchasers.

In order to assist the Authority in considering whether the conditions subsequent have been satisfied and consent to share sale can be granted, Ofgem requests that Transco provide it with a report addressing the matters raised below.

¹ Blackwater F Ltd, Blackwater SC A Ltd, Blackwater 2 Ltd and Blackwater G Ltd.

² The Authority’s conditions subsequent are set out in paragraph 23 of the Authority’s consent direction. *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 1

³ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11378_ASC29_hivedown_approval.pdf

⁴ MGN Gas Networks (Senior Finance) Limited, Gas networks Limited and Scotia Gas Networks plc.

⁵ It is noted that as part of its consideration of the condition subsequent contained in paragraph 23(c) of the Authority’s Consent Directions, the Authority will have regard to the extent to which Transco has complied with the additional requirement relating to flow flexibility as set out in Ofgem’s open letter entitled *Final approval for hive-down of NGT’s gas distribution networks* dated 29 April 2005.

As we consider that this report will be of interest to a broad range of industry participants and other interested parties, it is proposed that this letter and Transco's response (insofar as it is not confidential) will be published on Ofgem's website.

The report should be provided on behalf of each of:

- ◆ National Grid Transco plc (NGT), as the ultimate controller of Transco plc and as the current ultimate controller of each of the four DN companies;
- ◆ Transco plc, as the holder of two relevant gas transporters (GT) licences (i.e. the GT licence in respect of the National Transmission System (NTS) business and the GT licence in respect of the retained DN (RDN) business); and
- ◆ each of the four DN companies as holders of the four relevant GT licences relating to the four independent DNs (IDNs).

The Authority requests that Transco, on behalf of each of the companies specified above, acting as reasonable and prudent operators and having made due and careful inquiry of all relevant and interested parties (including without limitation potential purchasers, shippers, suppliers and independent gas transporters) and having regard to their licence and wider statutory obligations provides the Authority with a report which addresses the following matters:

1. Are there any issues associated with the Uniform Network Code (UNC) or other aspects of the industry code arrangements (including without limitation any or all of the various 'short form' network codes, the joint governance arrangements agreement and/or the agency services agreement), which would (in order to ensure that each of the above companies' licence and wider statutory obligations and the Authority's principal objective and other statutory and public law duties are fulfilled) require:
 - (a) changes to be made to the UNC, or other aspects of the industry code arrangements, prior to the completion of the share sale; and/or
 - (b) modifications to be proposed under the UNC modification rules in order to resolve issues that were overlooked as a part of the UNC development process?

In the event that you are aware of such issues, please provide details and a suggested way forward (including whether you propose to request urgent status in relation to any modification proposal and an assessment of materiality of the issues identified).

2. Whether you consider that UK-Link and all other relevant IT systems are fully operational to work in and support a divested industry structure post completion of share sale? The response should consider (without limitation):
 - (a) each of the systems of:
 - xoserve;
 - Transco NTS;
 - Transco RDNs;
 - IDNs;
 - independent gas transporters; and
 - shippers;
 - (b) any systems that are required to interface between one or more of the parties listed in (a) above; and
 - (c) the results of the industry's end-to-end system testing.

In the event that you identify any operational issues, including (without limitation) data transfer issues, please provide details of the issue, as well as your view of the materiality of the issue and a suggested way forward.

In this respect, Ofgem also specifically requests that Transco report on whether potential buyers are fully satisfied that their own IT systems (and those of the DN companies which they propose to acquire) are fully operational to work in and support a divested industry structure post share sale having regard to the need to interface with a wide variety of interested parties, including without limitation, shippers, suppliers and independent gas transporters.

3. Whether, in respect of each of the six relevant GT licences, you are aware of any issues that need to be resolved prior to receiving all Health and Safety Executive (HSE) approvals required prior to completion of share sale. If there any such issues please identify them. In addition please indicate whether you have received all necessary HSE approvals. Please note that among other things, and without limitation, Ofgem expects to receive copies of all HSE approval letters before it gives unconditional consent to share sale.
4. In respect of each of the six relevant GT licences:
 - (a) Whether you are aware of any issues associated with the operation of the licences that give rise to a requirement to modify the licence(s) (in order to ensure that each of the above companies statutory obligations and the Authority's principal objective and other statutory and public law duties are fulfilled. If there are any such issues please report on whether the modifications need to occur before the completion of any sale of shares in the DN companies to third party purchasers;
 - (b) Whether all necessary consents, clearances, permissions, authorisations or approvals required by Transco NTS, Transco RDN and each DN company on completion of share sale have been applied for and granted by the Authority to take effect on 1 June 2005. If any consents, clearances, permissions, authorisations or approvals remain outstanding at this time, please provide details. Your report should also indicate whether each of the DN purchasers agrees (or not as the case may be) with your assessment.
 - (c) Whether, assuming share sale proceeds on 1 June 2005, Transco NTS and Transco RDN and each DN company will be in a position to comply in full with its licence obligations, including conditions imposed by consents, on that date.
5. In relation to both the business separation arrangements in place between the NTS and the RDNs and the undertaking provided in accordance with Special Condition C19, whether Transco NTS has entered into arrangements with Transco RDN business on terms which are effective from the date of completion of share sale or earlier, and which do not unduly differ from corresponding contractual arrangements entered into with the four relevant DN companies and which would be entered into as contractual arrangements if the Transco RDN business were not held within the same legal entity.

For the avoidance of doubt, and without limitation to any other issue, the Authority would expect to have confirmation that the arrangements described above have been entered into.

6. Whether Transco NTS has entered into arrangements with both Transco RDN, and each of the four relevant DN companies, to ensure that customers do not bear any of the costs associated with the unconstrained incremental release of NTS offtake flexibility. Ofgem also requests that Transco report on whether these arrangements continue until such time as NTS 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, and without limitation to any other issue, the Authority would expect to have confirmation that the arrangements described above have been entered into.

7. Whether the new contractual arrangements relating to independent networks are in place and whether, in particular, all relevant contracts have been novated to the relevant DN companies. In the event that you identify any contracts that are not in place, please provide details of the contract and a suggested way forward.
8. Whether Transco (in respect of both its NTS and RDN licences) and each of the four relevant DN companies have consented to the licence modifications which are the subject of the current section 23 consultation.⁶
9. Whether there any other issues that you consider that the Authority should be aware of or take into account in reaching its decision on whether to allow share sale to proceed on 1 June 2005. In the event that there are further issues that the Authority should be aware of, please provide details of the issue, as well as your view of the materiality of the issue and a suggested way forward.

Ofgem would remind NGT, Transco plc, and the four relevant DN companies that in responding to this letter, each should have regard to their respective obligations under their licences and the Gas Act 1986.

Further, we request that each company referred to in the above paragraph acknowledges in writing in the reply that, in the event that the information provided in your report is misleading or inaccurate, whether intentionally or otherwise, the Authority may take enforcement or other appropriate action, now or in the future (and regardless of share sale), against any or all of NGT, Transco plc and/or the four relevant DN companies in respect of any or all of the six GT licences as they will have been the ultimate controller and/or holders of the licences at the time this information is provided.

In issuing this letter, it is important to make clear that there can be no expectation on the part of NGT, Transco, DN companies, DN purchasers or any other interested parties as to any further decisions which the Authority may be required to take in relation to the proposed transaction, including without limitation, any decisions in respect of whether the conditions subsequent have been met in full and any subsequent decisions regarding share sale. Nothing in this letter shall fetter the discretion of the Authority.

I would be grateful if you could provide your report by no later than 8am on Wednesday 25 May 2005. If you have any queries or comments, please don't hesitate to contact me or Mark Feather on 0207 901 7437.

Yours sincerely,

Sonia Brown
Director, Transportation

⁶ *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*, Ofgem, April 2005. This consultation closes on 24 May 2005.