

**DIRECTION RELATING TO THE PROPOSED DISPOSAL BY TRANSCO OF THE ENTIRE
ISSUED SHARE CAPITAL IN FOUR RELEVANT WHOLLY OWNED TRANSCO SUBSIDIARY
COMPANIES TO THIRD PARTY PURCHASERS**

Proposed Transaction

1. This Direction is issued by the Gas and Electricity Markets Authority (the “Authority”) in connection with National Grid Transco plc’s (“NGT”) proposed sale of one or more of Transco plc’s (“Transco”) local gas distribution networks (“DNs”) (the “Proposed Transaction”).
2. Transco (registered in England and Wales with company number 2006000 and whose registered office is at 1-3 Strand, London WC2N 5EH) is the holder of a gas transporters (“GT”) licence treated as granted under section 7 of the Gas Act 1986 (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”).
3. This Direction is issued by the Authority further to the four consent directions¹ (the “Consent Directions”) issued by the Authority on 31 January 2005 pursuant to Amended Standard Condition 29 (Disposal of assets) of the Original Transco Licence and pursuant to paragraph 3 of Schedule 3 to the Act relating to the disposal (also referred to in this Direction as the “hive-down”) by Transco of four DN businesses² to the following four wholly owned Transco subsidiary companies:
 - (a) Blackwater 2 Limited (registered in England and Wales with company number 5046791 and whose registered office is at 1-3 Strand, London, WC2N 5EH);

¹ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074_2105b.pdf

² The Wales and West DN; the North of England DN; South of England DN and the Scotland DN.

- (b) Blackwater F Limited (registered in England and Wales with company number 5167070 and whose registered office is at 1-3 Strand, London, WC2N 5EH);
 - (c) Blackwater G Limited (registered in England and Wales with company number 5167021 and whose registered office is at 1-3 Strand, London, WC2N 5EH); and
 - (d) Blackwater SC A Limited (registered in Scotland with company number SC264065 and whose registered office is at 191 West George Street, Glasgow, G2 2LD, Scotland.
4. Transco has informed the Authority that in August 2004, it entered into conditional sale and purchase option deeds with a number of third party purchasers in connection with the Proposed Transaction (the "Purchasers"). These Purchasers are as follows:
- (a) MGN Gas Networks (Senior Finance) Limited registered in England and Wales with company number 5149493 and whose registered office is at Level 30, CityPoint, 1 Ropemaker Street, London EC2Y 9HD. MGN Gas Networks (Senior Finance) Limited is owned by a consortium comprising Macquarie Bank Limited, Macquarie European Infrastructure Fund LP, Development Australia Fund Management Limited (as trustee of the Infrastructure Unit of the pooled superannuation trust known as Development Australia Fund), Northwestern Mutual Life Insurance Company, Macquarie Global Infrastructure Fund II, Challenger Life No.2 Limited, AMP Life Limited and Canada Pension Plan Investment Board. MGN Gas Networks (Senior Finance) Limited is proposing to acquire indirectly (through the acquisition from Transco of the entire issued share capital of Blackwater 2 Limited) the Wales and West DN.
 - (b) Gas Networks Limited registered in England and Wales with company number 5213525 and whose registered office is at Kempson House, Camomile Street, London EC3A 7AN. Gas Networks Limited is owned by a consortium comprising Cheung Kong Infrastructure Holdings Limited, Hong Kong Electric Holdings Limited, the Li Ka Shing (Overseas) Foundation and United Utilities Contract Solutions Limited. Gas Networks Limited is proposing to acquire indirectly (through the acquisition from Transco of the entire issued share capital of Blackwater F Limited) the North of England DN.

- (c) Scotia Gas Networks Limited registered in England and Wales with company number 4958135 and whose registered office is at 55 Vastern Road, Reading RG1 8BU. Scotia Gas Networks Limited is owned by a consortium comprising Scottish and Southern Energy plc, Borealis Infrastructure Management Inc. and Ontario Teachers Pension Plan. Scotia Gas Networks Limited is proposing to acquire indirectly (through the acquisition from Transco of the entire issued share capital of Blackwater G Limited and Blackwater SC A Limited) the South of England DN and the Scotland DN.

Background

5. 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.
6. 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 Transco³ and Transco formally withdrew its remaining three applications.
7. 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 website⁴.
8. Until 1 February 2005, all gas transportation assets owned by Transco were operated pursuant to the Original Transco Licence and the five Additional Licences, whilst active, did not relate to any particular gas transportation assets owned or operated by Transco.
9. The Original Transco Licence and the five Additional Licences are together referred to in this Direction as the "Six Licences".

³ 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.

⁴[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9161 A copy of the GT Licences issued to Transco 05.11.04 pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9161_A%20copy%20of%20the%20GT%20Licences%20issued%20to%20Transco%2005.11.04.pdf)

The Modification process to date: November 2004 section 23 notice

10. 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 Licences⁵ (the “Initial S.23 Notice”) together with an explanatory document⁶.
11. The Initial S.23 Notice consulted on the Authority’s proposal (as part of the Proposed Transaction) to separate the price controls (as set out in the Original Transco Licence) to achieve revenue separation between Transco’s National Transmission System (the “NTS”) and each of the DNs which are proposed to be disposed of by Transco (the “IDNs”) and each of the DNs which are proposed to be retained by Transco (the “RDNs”). The Initial S.23 Notice stated that the effect of the proposed modifications would be that each of the five Additional Licences would relate to specific DN assets and the Original Transco Licence would relate to the NTS assets only.

January Authority decision

12. It was made clear in the Initial S.23 Notice and the accompanying explanatory document that the modifications proposed in the Initial S.23 Notice would only be directed by the Authority provided that the Authority granted its consent to Transco to hive-down the four relevant IDNs under Amended Standard Condition 29 of the Original Transco Licence.
13. 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.
14. On 20 January 2005, the Authority met at a duly convened Authority meeting to consider Transco’s applications. After careful consideration, the Authority granted the four Consent Directions to Transco under Amended Standard Condition 29 of the Original Transco Licence to dispose of each of the four relevant IDNs from Transco to its four relevant wholly owned subsidiary companies. As the consents contained in the

⁵ http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=,1_8936#top8936

⁶ 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

Consent Directions were granted on a conditional basis⁷, Transco was required to satisfy a number of conditions precedent before the consents became effective. In addition, the Authority also attached a number of conditions subsequent to its consents. In particular, and without limitation, under NGT's commercial timetable for the Proposed Transaction, at the time that the hive-downs were expected to complete, the regulatory, commercial and operational arrangements which in the Authority's opinion would be necessary to protect the interests of customers in the context of the Proposed Transaction were not in place. Transco was therefore required to retain the legal and beneficial ownership of the entire issued share capital of each of the four relevant wholly owned subsidiary companies and was prohibited from directly or indirectly disposing of such shares or in any way relinquishing control directly or indirectly over the four relevant wholly owned subsidiary companies without the Authority's prior written consent. This Direction relates to the grant of such consent.

15. It is noted that the proposed hive-down of the four relevant IDNs from Transco to its four wholly owned subsidiary companies also required 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 2005⁸.

Initial S.23 Notice and direction to modify the Licences

16. Following the Authority's decision on 20 January 2005, 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 2005⁹.
17. This resulted in revenue separation between the NTS and each of the four IDNs which were proposed to be disposed of by Transco and each of the four RDNs which were proposed to be retained by Transco. As at 1 February 2005, four of the Additional Licences respectively related only to each of the four IDNs (the "IDN Additional

⁷ For further detail on the conditions to consent see Appendix 2 to the Authority's February 2005 Decision Document http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074_2105b.pdf

⁸ http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf

⁹ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043_2405.pdf

Licences”), one of the Additional Licences related only to the four RDNs retained by Transco (the “RDN Additional Licence”) and the Original Transco Licence related only to the NTS.

Modifications to the Six Licences and the April Authority meeting

18. 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 further modifications to each of the Six Licences¹⁰ together with an explanatory document. 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 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 further modifications to the four IDN Additional Licences as a condition to the Proposed Transfers. The notice published pursuant to section 23(3) of the Act (the “Second S.23 Notice”) proposed to further modify the conditions of the Original Transco Licence and the RDN Additional Licence.
19. The Second S.23 Notice and the S.8AA Notice stated that the effect of the proposed modifications would be to restructure each of the Six Licences 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.
20. 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 four 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.
21. 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:

¹⁰ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10235_Finalversionofformalconsultation.pdf

- (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);
 - (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 and, accordingly, on 1 May 2005 Transco's existing network code would therefore become the NTS and RDN businesses' short form network 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 later 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 Licence be modified on 25 April 2005 but that such modifications would take effect on 1 May 2005 (or such later date as the Authority may direct) by way of a separate direction (the "S.23 Associated Direction").
22. As a result of the ASC 29 Decision Letter, the 0745 Decision Letter, the S.8AA Consent and Direction and the Second S.23 Direction, the Authority permitted Transco to take the necessary steps towards proceeding to hive-down on 1 May 2005. However, as stated in each of those documents, although made on 25 April 2005, the relevant modifications and decisions did not come into effect until the Authority issued a further series of directions.
23. On 1 May 2005, pursuant to the S.8AA Associated Direction and the S.23 Associated Direction, the modifications to restructure the Six Licences were brought into effect, Transco's network code was modified to become the NTS and RDN businesses' short form network code and each of the IDN Additional Licences were transferred from

Transco to each of Blackwater 2 Limited, Blackwater F Limited, Blackwater G Limited and Blackwater SC A Limited respectively.

24. As part of the Proposed Transaction, on 1 May 2005 Transco also hived-down the four relevant IDNs from Transco to the four relevant wholly owned subsidiary companies, as shown in Table 1 below.

Table 1:

DN	Relevant wholly owned Transco subsidiary company
The Wales and West DN	Blackwater 2 Limited
The North of England DN	Blackwater F Limited
The South of England DN	Blackwater G Limited
The Scotland DN	Blackwater SC A Limited

Third Section 23 Notice

25. At the time of hive-down of the IDNs from Transco to the four wholly owned Transco subsidiary companies, the regulatory arrangements which, in the Authority's opinion, would be necessary to protect the interests of customers in a divested industry structure were not fully in place. Further modifications to each of the Six Licences were therefore considered to be necessary in order to seek to ensure that customers' interests are protected in a divested industry structure.
26. As a result, on 26 April 2005, the Authority pursuant to section 23(3) of the Act, gave notice (the "Third S.23 Notice")¹¹ that it was proposing, as part of the Proposed Transaction, to modify further the conditions of each of the Six Licences as set out in the Third S.23 Notice, the annexes and the explanatory document¹² (including its appendices) which accompanied the Third S.23 Notice.

¹¹ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11329_Appendix_6_S23notice.pdf

¹² http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11343_FinalProposalsforInterimIncentivesFormalconsultation.pdf

27. The Third S.23 Notice was in two parts. Part 1 related to general modifications in response to views to the consultation conducted by the Authority in relation to the S.8AA Notice and the Second S.23 Notice. Part 2 related to the introduction of interim incentive arrangements on the NTS and DNs 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.
28. On 25 May 2005, with the written consent of Transco, Blackwater 2 limited, Blackwater F Limited, Blackwater G Limited and Blackwater SCA Limited (as required by section 23 of the Act) and in accordance with the powers contained in section 23 of the Act, the Authority directed (the "Third S.23 Direction") that each of the Six Licences be modified in the form set out in the Third S.23 Direction but that such modifications shall take effect on 1 June 2005. The modifications shall take effect in the case of each IDN Additional Licence contemporaneously with the completion of the sale of the shares in respect of the relevant company and in the case of the Original Transco Licence and the RDN Additional Licence immediately after the completion of the share sales which actually take place on 1 June 2005 in each case in accordance with the terms of the Third S.23 Direction.

Other Decisions made by the Authority

29. In relation to the consideration of conditions subsequent attached to the Consent Directions, the Authority has today issued an open letter (the "Conditions Subsequent Letter")¹³ stating that the conditions subsequent had been sufficiently satisfied to allow Transco to complete each of the Option Deeds and thereby sell the entire issued share capital in each of the four relevant wholly owned subsidiary companies to the Purchasers (the "Proposed Disposals") on 1 June 2005.

Consent

30. Having carefully considered Transco's request and respondents' views to various consultations and having had regard to the relevant papers and to its principal objective and statutory and other duties, the Authority hereby consents that, subject to paragraphs 31 to 35 below, Transco may undertake each of the Proposed Disposals.

¹³Gas Distribution Network Sales – Final consent to sale of four of National Grid Transco's gas distribution networks. May 2005

31. The consent of the Authority set out in this Direction is in all respects subject to the requirement that Transco shall complete the Proposed Disposals pursuant to the consent set out in this Direction:

(a) not earlier than 00:01 hours British Summer Time (“BST”) on 1 June 2005; and

(b) not later than 23:59 hours BST on 1 June 2005.

32. In the event that the requirement set out in sub-paragraph 31(b) above is not satisfied in relation to one or more of the Proposed Disposals and the Authority has not exercised its discretion in respect of such Proposed Disposal or Proposed Disposals pursuant to paragraph 33 below, the consent contained in this Direction shall cease to be valid in respect of such Proposed Disposal or Proposed Disposals if and at the time that the Authority issues a notice in writing to Transco to that effect.

33. If the requirement set out in sub-paragraph 31(b) above is not satisfied in relation to one or more of the Proposed Disposals or if at any stage (including for the avoidance of doubt either before or after the time and date set out in sub-paragraph 31(b) above) the Authority is of the opinion that such requirement is unlikely to be or has not been satisfied in relation to one or more of the Proposed Disposals, the Authority shall be entitled at its sole discretion to:

(a) waive the requirement in relation to the relevant Proposed Disposal or Proposed Disposals; or

(b) extend the period for satisfying the requirement to an alternative date and / or time in relation to the relevant Proposed Disposal or Proposed Disposals.

34. In the event that:

(a). the completion of one or more Proposed Disposals has not occurred in accordance with the terms of paragraph 31(b) above;

(b). the Authority has not issued a notice pursuant to paragraph 32 above in relation to such Proposed Disposal or Proposed Disposals; and

(c). the Authority has exercised its discretion pursuant to paragraph 33 above in relation to such Proposed Disposal or Proposed Disposals,

the Authority shall be entitled to vary or otherwise modify the requirements of paragraph 31(b) in relation to such Proposed Disposal or Proposed Disposals including for the avoidance of doubt the imposition of new requirements which must be satisfied before such Proposed Disposal or Proposed Disposals can complete.

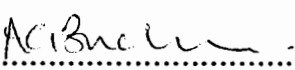
35. For the avoidance of doubt, the consent set out in this Direction relates to each of the Proposed Disposals individually. For the purposes of this Direction, the failure by Transco to complete one or more of the Proposed Disposals in accordance with the terms of the consent set out in this Direction shall not, on its own, affect Transco's ability to complete one or more of the other Proposed Disposals.

36. Pursuant to section 38A of the Act the reasons for making this Direction are stated in:

- (a). the documents referred to in this Direction;
- (b). the Third S.23 Direction;
- (c). the documents listed or referred to in the Third S.23 Direction; and
- (d). all other documents published by Ofgem or the Authority in connection with the Proposed Transaction on 25 and 26 May 2005.

37. Copies of the documents referred to in paragraph 36 are available (free of charge) from the Ofgem library, 9 Millbank, London SW1P 3GE (telephone 020 7901 7003) or on the Ofgem website at www.ofgem.gov.uk.

Dated 25 May 2005

Signed..........

Alistair Buchanan

duly authorised by the Authority