

**To:**

**The Company Secretary  
Transco plc (Company number 2006000)  
1 – 3 Strand  
London  
WC2N 5EH**

**The Company Secretary  
Blackwater 2 Limited (Company number 5046791)  
1 – 3 Strand  
London  
WC2N 5EH**

**The Company Secretary  
Blackwater F Limited (Company number 5167070)  
1 – 3 Strand  
London  
WC2N 5EH**

**The Company Secretary  
Blackwater G Limited (Company number 5167021)  
1 – 3 Strand  
London  
WC2N 5EH**

**The Company Secretary  
Blackwater SC A Limited (Company number SC 264065)  
191 West George Street  
Glasgow  
G2 2LD**

**MODIFICATIONS TO THE GAS TRANSPORTERS LICENCES HELD BY  
TRANSCO PLC, BLACKWATER 2 LIMITED, BLACKWATER F LIMITED,  
BLACKWATER G LIMITED AND BLACKWATER SC A LIMITED**

**DIRECTION PURSUANT TO SECTION 23 OF THE GAS ACT 1986  
(the “Direction”)**

**Summary**

1. This Direction is made 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”).

## Background

2. Transco 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. 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.
4. 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 Transco<sup>1</sup> and Transco formally withdrew its remaining three applications.
5. 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 website<sup>2</sup>.
6. 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.
7. The Original Transco Licence and the five Additional Licences are together referred to in this Direction as the "Six Licences".

## The Modification process to date: November 2004 section 23 notice

8. 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 Licences<sup>3</sup> (the "Initial S.23 Notice") together with an explanatory document<sup>4</sup>.

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<sup>1</sup> 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.

<sup>2</sup> [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_copy_of_the_GT_Licences_issued_to_Transco_05.11.04.pdf)

<sup>3</sup> [http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/arcasofwork/gasdistributionnetworksale&levelids=.l\\_8936#top8936](http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/arcasofwork/gasdistributionnetworksale&levelids=.l_8936#top8936)

<sup>4</sup> 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

9. 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 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 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**

10. 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.
11. 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.
12. On 20 January 2005, the Authority met at a duly convened Authority meeting to consider Transco's applications. After careful consideration, the Authority granted four conditional consents (the "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 Consent Directions were granted on a conditional basis<sup>5</sup>, 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 consent. In particular, and without limitation, the Authority's further consent is required in relation to a number of areas of the Proposed Transaction. For example, Transco is prohibited from disposing or relinquishing control (directly or indirectly) of the shares in the four relevant wholly owned subsidiary companies without the prior written consent of the Authority.

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<sup>5</sup> For further detail on the conditions to consent – see Appendix 2 to the Authority February 2005 Decision Document [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074\\_2105b.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10074_2105b.pdf)

13. 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 2005<sup>6</sup>.

#### **Initial S.23 Notice and direction to modify the Licences**

14. 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 2005<sup>7</sup>.
15. 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 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**

16. 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 Licences<sup>8</sup> 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 modify further the conditions of the Original Transco Licence and the RDN Additional Licence.
17. 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

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<sup>6</sup> [http://www.dti.gov.uk/energy/publications/policy/sale\\_gas\\_dist\\_networks\\_reasons.pdf](http://www.dti.gov.uk/energy/publications/policy/sale_gas_dist_networks_reasons.pdf)

<sup>7</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043\\_2405.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10043_2405.pdf)

<sup>8</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11298\\_ASC29\\_letter.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11298_ASC29_letter.pdf)

industry structure with the intention of protecting the interests of customers in the event that Transco sells one or more of its IDNs.

18. 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.
19. 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<sup>9</sup>;
  - (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 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

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<sup>9</sup> 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.

May 2005 (or such later date as the Authority may direct) by way of a separate direction (the "S.23 Associated Direction").

20. 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 (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 did not come into effect until the Authority issued a further series of directions.
21. 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.
22. 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:**

<b>DN</b>	<b>Wholly Owned Transco Subsidiary</b>
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

23. Transco now proposes to sell the entire issued share capital in each of the four relevant wholly owned subsidiary companies to third party purchasers. Transco proposes to retain the RDN Additional Licence and the Original Transco Licence in respect of its NTS business (it is proposed that both licences be held by Transco in the same legal entity).

### Third Section 23 Notice

24. 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, will 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 are therefore required in order to seek to ensure that customers' interests are protected in a divested industry structure.
25. As a result, on 26 April 2005, the Authority pursuant to section 23(3) of the Act, gave notice (the "Third S.23 Notice")<sup>10</sup> that it was proposing, as part of the Proposed Transaction, to further modify the conditions of each of the Six Licences as set out in the Third S.23 Notice, the annexes and the explanatory document (including its appendices) which accompanied the Third S.23 Notice<sup>11</sup>.
26. The Third S.23 Notice was in two parts. Part 1 related to general modifications in response to views of the respondents 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 in response to views of the respondents to the consultation conducted by the Authority in relation to the S.8AA Notice and the Second S.23 Notice. The Authority noted that if, following consideration of respondents' views in relation to the Third S.23 Notice, the Authority considered 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, reserved the right to consider it appropriate to direct the modifications proposed in the Third S.23 Notice in part only.
27. In the Third S.23 Notice, the Authority noted that, as the Third S.23 Notice preceded the bringing into effect of Standard Special Conditions A2, B2 and D2<sup>12</sup> which contained the private collective licence modification procedure (the "Private CLM Conditions"), the Authority did not propose to use the collective licence modification procedure contained in these conditions. However, the Authority noted that, had the Private CLM Conditions been effective in each of the Six Licences, the licence modification procedure contained in those conditions would have been used in relation to conditions proposed to be introduced into

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<sup>10</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11329\\_Appendix\\_6\\_S23notice.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11329_Appendix_6_S23notice.pdf)

<sup>11</sup> [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11343\\_FinalProposalsforInterimIncentivesFormalconsultation.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11343_FinalProposalsforInterimIncentivesFormalconsultation.pdf)

<sup>12</sup> These conditions came into effect on 1 May 2005.

Parts A, B and/or D respectively although the Special Conditions in Parts C and E would still be subject to the modification procedure provided in section 23 of the Act. Accordingly, the relevant licence holders have been asked to consent to the modifications as set out in this Direction, and also to confirm their acceptance that the conditions introduced into Parts A, B and/or D pursuant to this Direction 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.

28. The Authority noted that, following the transfer of the IDN Additional Licences to each of Blackwater 2 Limited, Blackwater F Limited, Blackwater G Limited and Blackwater SC A Limited on 1 May 2005, it would be necessary to obtain Transco's consent and the consent of Blackwater 2 Limited, Blackwater F Limited, Blackwater G Limited and Blackwater SC A Limited to the modifications proposed in the Third S.23 Notice in accordance with the requirements of section 23(6) of the Act as they are now the respective holders of the relevant licences.
29. The Authority sent a copy of the Third S.23 Notice to the Secretary of State and has not received any objection or direction not to make the modifications to the Six Licences.

#### **Responses to the Third S. 23 Notice**

30. By the close of the consultation period in respect of the Third S.23 Notice, the Authority received five responses (excluding Transco's response) none of which were marked as confidential. No responses were withdrawn. The responses have been placed in the Ofgem library and are available on the Ofgem website<sup>13</sup>.
31. A summary of respondents' views is attached in Schedule 1 to this Direction.
32. The Authority has carefully considered representations or objections made to it and not withdrawn in relation to its proposal to modify the Six Licences.
33. Following publication of the Third S.23 Notice, Ofgem received notification of a number of minor non-material errors in the drafting provided in relation to the proposed modifications. Details of such minor non-material errors are set out in Schedule 2 to this Direction.
34. In the Authority's view, the above corrections and changes are non-material. Having considered the errors and having regard to its powers and duties under the Act, the

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<sup>13</sup> [http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1\\_10692#top10692](http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale&levelids=.1_10692#top10692)



Authority has decided to incorporate each of the corrections and changes without further consultation and considers that these changes fall within section 23 of the Act.

#### **Other Decisions made by the Authority**

35. Today, the Authority met at a duly convened Authority meeting to consider various aspects of the Proposed Transaction including, without limitation, the conditions subsequent attached to the Consent Directions. Having due regard to its principal objective and statutory and other public law duties and the statutory duties of GTs, and having carefully considered representations to the various consultations and its decisions in January 2005 (described at paragraphs 10 to 13 above) and April 2005 (described at paragraphs 16 to 23 above), the Authority has today issued an open letter (the "Conditions Subsequent Letter")<sup>14</sup> stating that the conditions subsequent have been sufficiently satisfied to allow share sale to proceed on 1 June 2005.
36. On 25 May 2005, as required under section 23 of the Act, Transco provided the Authority with its written consent (i) to the making of the proposed modifications to the Original Transco Licence and the RDN Additional Licence today in the form set out in Schedule 3 to this Direction; and (ii) confirming its acceptance that any conditions to be introduced into Parts A, B and/or D of the Original Transco Licence and the RDN Additional Licence would be subject to the Private CLM Conditions, such modifications to take effect on 1 June 2005.
37. On 25 May 2005, as required under section 23 of the Act, Blackwater 2 limited, Blackwater F Limited, Blackwater G Limited and Blackwater SC A Limited provided the Authority with their written consent (i) to the making of the proposed modifications to the IDN Additional Licences today in the form set out in Schedule 3 to this Direction and (ii) confirming their acceptance that any conditions to be introduced into Parts A, B and/or D of the IDN Additional Licences would be subject to the Private CLM Conditions, such modifications to take effect on 1 June 2005.

#### **Direction to modify**

38. With the written consent of Transco, Blackwater 2 limited, Blackwater F Limited, Blackwater G Limited and Blackwater SC A Limited (as required in terms of section 23 of the Act) and in accordance with the powers contained in section 23 of the Act, the

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<sup>14</sup> Gas Distribution Network Sales – Final consent to sale of four of National Grid Transco's gas distribution networks May 2005

Authority hereby directs that each of the Six Licences be modified today in the form set out in Schedule 3 to this Direction but that such modifications shall take effect as follows:-

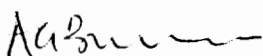
- (a). in relation to the IDN Additional Licence held by Blackwater 2 Limited, the modifications shall take effect contemporaneously with the completion of the sale of shares in Blackwater 2 Limited to the relevant third party purchaser on 1 June 2005;
- (b). in relation to the IDN Additional Licence held by Blackwater F Limited, the modifications shall take effect contemporaneously with the completion of the sale of shares in Blackwater F Limited to the relevant third party purchaser on 1 June 2005;
- (c). in relation to the IDN Additional Licence held by Blackwater G Limited, the modifications shall take effect contemporaneously with the completion of the sale of shares in Blackwater G Limited to the relevant third party purchaser on 1 June 2005;
- (d). in relation to the IDN Additional Licence held by Blackwater SC A Limited, the modifications shall take effect contemporaneously with the completion of the sale of shares in Blackwater SC A Limited to the relevant third party purchaser on 1 June 2005; and
- (e). in relation to the Original Transco Licence and the RDN Additional Licence, the modifications shall take effect immediately after the completion of such of the share sales listed in sub-paragraphs (a) to (d) above that actually complete on 1 June 2005.

39. Pursuant to section 38A of the Act the reasons for making this Direction to modify each of the Six Licences as set out in the Schedules to this Direction are stated in:

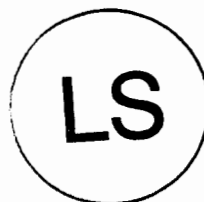
- (a). the Third S.23 Notice;
- (b). the documents listed in the Third S.23 Notice;
- (c). all other documents published by Ofgem or the Authority in connection with the Proposed Transaction on 25 and 26 May 2005.

40. Copies of the documents referred to in paragraph 39 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](http://www.ofgem.gov.uk).

The Official Seal of the Gas and Electricity Markets Authority is affixed to this Direction and is authenticated by:

  
.....  
**Alistair Buchanan**

**Duly authorised by the  
Gas and Electricity Markets Authority**



**25 May 2005**

## **SCHEDULE 1**

### **RESPONDENTS' VIEWS**

Please refer to the attached separate document

## SCHEDULE 2

### NON MATERIAL CORRECTIONS

#### Table of corrections

1. As part of this Direction, and having regard to its powers and duties under the Act, the Authority has decided to incorporate a number of non-material corrections into the licence drafting, as published within the Third Section 23 Notice (Third S.23 Notice) published on 26 April 2005, without further consultation. These changes represent correction of minor typographical errors and are reflected in the licence drafting provided in Schedule 3. The Authority considers that these changes fall within section 23 of the Act. These changes have come to Ofgem's attention as the result of responses to the Third S.23 Notice (which are summarised in Schedule 1).
  
2. The licence drafting provided in Schedule 3 does not identify revisions, however, these are detailed in the table below.

Part of licence	Condition	Paragraph	Description of correction
Part A	Standard Special Condition A39. Indebtedness	5, definition of "cross-default obligation", sub-paragraph (iii)	Replace "paragraphs 1(a), 1(b) or 1(c)" with paragraphs "1(a), 1(b), 1(c) or 1(d)".
Part 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 NTS system operation activity.	1, Table entitled "NTS exit capacity buy-back and interruption incentive information", entry for ExBBC <sub>d,t</sub>	In second column, replace "Entry capacity buy-back costs" with "Exit capacity buy-back costs".

### **SCHEDULE 3**

#### **FORM OF LICENCE MODIFICATIONS**

Please refer to the attached separate document.