

All interested parties

Email: NGGD.Separation@ofgem.gov.uk

Date: 08 July 2016

National Grid's intended sale of its Gas Distribution Networks Statutory licence consultations under section 8AA and section 23 of the Gas Act 1986

On 10 November 2015, National Grid plc (**NG**) announced the commencement of a process for the intended sale of a majority stake in its gas distribution network business, currently owned by a subsidiary of NG, National Grid Gas plc (**NGG**). NG stated it intended to commence the sale process in the second half of 2016 and it was likely to be completed in early 2017. This sale process would consist of two stages:

1. **hive across** – NGG would transfer its gas distribution assets and licence to a new licensed subsidiary of NG, namely National Grid Gas Distribution Ltd (**NGGDL**), and
2. **share sale** – NG then intends to sell a majority of its shares in NGGDL.

We¹ granted conditional consent to the transfer of assets by NGG to NGGDL on 06 July 2016² under Standard Special Condition A27 of the gas transporter licence held by NGG for its distribution network (**NGG(DN)**). Section 8AA(1) of the Gas Act 1986 (**the Act**) provides that a licence shall be capable of being transferred with the consent of the Authority. Section 8AA(4) provides that the consent can be given subject to modification or other conditions which must be complied with before the licence can be transferred. On 23 June 2016, NGG submitted an application to the Authority, seeking our consent to transfer the NGG(DN) gas transporter licence to NGGDL. We are therefore commencing two statutory consultations to seek stakeholder views before deciding whether to³:

- grant consent to the transfer of the NGG(DN) gas transporter licence to NGGDL (NG's new subsidiary) subject to modifications to the same licence under section 8AA of the Act, and
- make modifications under section 23 of the Act to the gas transporter licence held by NGG in respect of the national transmission system (**NGG(NTS)**).

These respective statutory consultations follow on from the consultation we conducted in May 2016^{4,5} to seek stakeholder views on various areas, in anticipation of receiving from

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² <https://www.ofgem.gov.uk/publications-and-updates/national-grid-sale-gas-distribution-network-business-decision-regulatory-aspects-and-transfer-assets>

³ The fact that we have granted conditional consent under Standard Special Condition A27 does not in any way fetter our decision-making under section 8AA or section 23 of the Act, nor in relation to any subsequent decision relating to NG's proposed sale.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/national-grid-sale-gas-distribution-network-business-decision-regulatory-aspects-and-transfer-assets>

NGG requests to consent to the transfer of assets and licence. In particular, the May 2016 consultation sought views on the regulatory issues arising from the potential transfer of gas distribution assets and the NGG(DN) gas transporter licence from NGG to another wholly owned subsidiary of NG (namely NGGDL). To provide early sight to stakeholders of the potential changes to the licences, and to seek views, in the May 2016 consultation we also consulted on the potential licence changes. We received no substantive comments on the proposed licence conditions modifications detailed in that consultation.⁶

Published alongside this letter are:

- Annex 1 – this sets out our minded to decision on the transfer of NGG(DN)'s gas transporter licence and provides a summary of proposed changes to NGG(DN)'s and NGG(NTS)'s gas transporter licences,
- Annex 2 – notice of a statutory consultation under section 8AA(9) of the Act, and
- Annex 3 – notice of a statutory consultation under section 23(2) of the Act.

Consultation question 1: do you agree with our minded to decision to grant consent to the transfer of NGG(DN)'s licence?

Consultation question 2: do you have any comments on the proposed modifications to the NGG(DN) gas transporter licence?

Consultation question 3: do you have any comments on the proposed modifications to the NGG(NTS) gas transporter licence?

Next Steps

Any representations with respect to:

- (a) the proposed licence transfer (subject to the proposed modification conditions) under section 8AA(9) in relation to the gas transporter licence held by NGG(DN), and
- (b) the proposed modifications under section 23(2) in relation to the gas transporter licence held by NGG(NTS)

should be sent to us by email on or before 9 September 2016 to:

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Unless clearly marked as confidential, all responses will be published on our website. It would be helpful if responses could be submitted in electronic form (so they can be placed easily on our website). Respondents may request that their response, or part of response is kept confidential and those who wish to do so should clearly mark their

[consultation-regulatory-aspects](#)

⁵ In addition to an informal consultation, we also issued a statutory consultation on proposed new standard special conditions and special conditions in the NGG(NTS) gas transporter licence. The statutory consultation was on the proposed modifications to provide us with the power to maintain NGG's obligation to act as a backstop meter provider of last resort (BMPOLR) in the event that the NGG(DN) licence were transferred.

⁶ We received comments on our initial view in one area (compliance officer and legal separation) for which we had not included licence modifications in our May 2016 consultation. Following consideration of these responses, we include licence conditions modifications in our statutory consultations.

documents to that effect and include reasons for confidentiality. Ofgem shall respect this request, subject to disclosure requirements, for example, under the Freedom of Information Act 2000 or the Environment Information Regulations 2004.

Subject to the responses we receive, we may decide to grant our consent to the transfer of the licence held by NGG(DN) under section 8AA (subject to the proposed modification conditions) and to make the proposed modifications under section 23 of the Act in respect of the licence held by NGG (NTS). In this event, changes to the NGG(NTS) gas transporter licence, pursuant to section 23 of the Act, will take effect not less than 56 days after the decision is published. Changes to NGG(DN) gas transporter licence, pursuant to section 8AA of the Act will take effect on the date specified in our decision.

Please contact Rupika Madhura if you have any questions with regards to this consultation.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Ian Rowson'.

Ian Rowson

Associate Partner, RIIIO Finance & Investor Relations, Networks Division

Duly authorised on behalf of the Gas and Electricity Markets Authority

Annex 1:

1. Minded to decision on consent for transfer of the NGG(DN) licence

On 23 June 2016, NGG submitted an application to the Authority, seeking our consent to transfer its NGG(DN) gas transporter licence to NGGDL.

The criteria that the Authority applies in deciding whether to grant consent to a proposed licence transfer⁷ are the same as we would apply if we were deciding to grant a new licence to the transferee (section 8AA(6) of the Act).

The Authority's minded to decision is to consent to the proposed licence transfer. We would only direct this licence transfer in the circumstance that:

- the proposed modifications to the NGG(DN) gas transporter licence and consequential changes to the NGG(NTS) gas transporter licence being made as explained below, and
- the conditions for the simultaneous transfer of the relevant assets have been satisfied as mentioned in our decision of 06th July on transfer of assets.

In this circumstance, the Authority is satisfied that it would have been appropriate to grant a gas transporter licence to NGGDL had NGGDL applied to the Authority for such a licence and, as such, considers that it would be appropriate to consent to a transfer of an existing gas transporter licence to NGGDL.

Consultation question 1: do you agree with our minded to decision to grant consent to the transfer of NGG(DN)'s licence?

2. Summary of proposed modifications to the NGG(DN) licence (distribution)

As a condition of the proposed licence transfer, modifications are proposed to the NGG(DN) gas transporter licence. The proposed modifications are in three groups.

1. Backstop meter provider of last resort (BMPOLR)

We have recently decided to modify the NGG(NTS) licence to include dormant BMPOLR obligations, which may be activated if the NGG(DN) licence is transferred away from NGG⁸. Our decision follows our statutory consultation letter dated 03 May 2016⁹. As such, should we grant our consent to the requested licence transfer and activate those obligations in the NGG(NTS) licence, we propose to remove the BMPOLR obligations from the NGG(DN) licence that will be transferred and held by NGGDL.

2. Compliance officer and legal separation

As part of the 2005 sale process, we decided that it would not be appropriate to require the legal separation of NGG's distribution business from NGG's transmission business. Instead, as well as requiring structural separation, we put in place licence conditions that

⁷ <https://www.ofgem.gov.uk/licences-codes-and-standards/licences/transferring-licence>

⁸ <https://www.ofgem.gov.uk/publications-and-updates/modification-national-grid-gas-plc-ngg-national-transmission-system-nts-s-gas-transporter-licence-add-dormant-back-stop-meter-provider-last-resort-obligations>

⁹ <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposed-new-standard-special-conditions-and-special-conditions-national-grid-gas-plc-s-national-transmission-system-nts-gas-transporter-licence>

were intended to deliver many of the benefits of legal separation. Some of these conditions reference and apply where a gas distribution licence and gas transmission licence are held by the same legal entity. Provided a hive across takes place, at the point of hive across, the transmission and distribution licences would be held by different legal entities and these conditions will cease to have effect. However, as described in our informal consultation and decision documents, we are of the view that legal separation does not remove the need for protection against undue discrimination in favour of a related party.

We propose to modify these licence conditions to ensure they apply in circumstances where related parties are carrying out both distribution and transmission activities. We consider parties to be related where there is a common ultimate controller.

3. References to National Grid Gas and the Competition Commission

We propose modifications to remove references to incorrect entities. These are references to (i) NGG, which will no longer be relevant in the event of a licence transfer; and (ii) the Competition Commission, which has been replaced by the Competition and Markets Authority.

In summary, the proposed changes to the NGG(DN) gas transporter licence are:

- Removal of Special Conditions 5A (Provision of Meters) and 5B (Provision of Terms), as these relate to BMPOLR obligations (which would be activated in the NGG(NTS) licence).
- Minor wording changes to Special Conditions 4E (Undertaking from ultimate controller concerning non-discrimination between the Distribution Network transportation activity and the NTS transportation activity) and 4F (Separation of NTS and Distribution Network Businesses) to ensure they apply to activities undertaken by related entities (and not solely requiring the activities to occur within the same legal entity).
- Removal of reference to NGG's gas distribution networks and correction of a cross reference (in para 7) in Standard Special Condition D17 (Provision and Return of Meters).
- Removal of references to 'NGGD' in:
 - Appendix 1 to Special Condition 1B (Restriction of revenue in respect of the Distribution Network Transportation Activity)
 - Appendix 1, 2 and 3 to Special Condition 1C (Distribution Network allowed pass-through items)
 - Appendix 1 and 2 to Special Condition 1D (NTS Exit Capacity Cost Adjustment)
 - Appendix 1, 2 and 3 to Special Condition 1F (Revenue adjustments for performance in respect of gas Shrinkage and environmental emissions)
 - Appendix 1 to Special Condition 1H (The Network Innovation Allowance)
 - Appendix 1 to Special Condition 3B (Determination of PCFM Variable Values for Totex Incentive Mechanism Adjustments)
 - Appendix 1 and 2 to Special Condition 3D (The Innovation Roll-out Mechanism)
 - Appendix 1 to Special Condition 3E (Mains and Services Replacement Expenditure)
 - Appendix 1 and 2 to Special Condition 3F (Arrangements for the recovery of uncertain costs)
 - Annex A to Special Condition 4J (Non Gas Fuel Poor Network Extension Scheme Incentive Mechanism).

- Amendment of references in Special Condition 4A (Disapplication of Relevant Special Conditions and Relevant Metering Special Condition) from the Competition Commission to the Competition and Markets Authority.

Consultation question 2: do you have any comments on the proposed modifications to NGG(DN)'s licence?

3. Summary of proposed modifications to the NGG(NTS) licence

As part of the proposed licence transfer, modifications would also be required to the NGG(NTS) licence. We have already consulted and subsequently decided to make changes in the NTS licence for BMPOLR¹⁰, as described above. The remaining proposed modifications are in two groups.

1. Compliance officer and legal separation

As above, we intend to modify the conditions to ensure they apply to related parties carrying out both transmission and distribution activities.

2. Calculation of pass through items

Special Condition 2B (Calculation of allowed pass-through items) of the NGG(NTS) licence deals with the treatment of pass-through items as part of the gas transmission revenue restriction. One pass-through item (dealt with in Part B of Special Condition 2B) relates to business rates. As currently drafted, Part B allows NGG(NTS) to recover 39.4% of the overall business rate charge on NGG (ie including gas distribution and transmission activities) from its transmission revenues.

In the event of hive across, NGG(NTS) would be responsible for business rates levied on NGG in respect of the transmission business, but will cease to be liable in respect of any business rates levied in respect of the distribution business (which will become the responsibility of NGGDL). We are proposing to delete the reference to 39.4% of distribution business rates.

In summary, the proposed changes to the NGG(NTS) licence are:

- Changes to Special Conditions 10A (Undertaking from ultimate controller concerning non-discrimination between the NTS Transportation Owner Activity and the Distribution Network Transportation Activity), 10B (Separation of NTS and Distribution Network Businesses), and 10C (Appointment and duties of the business separation compliance officer) to ensure they apply to activities within related entities.
- Change references regarding pass through from NGG's overall business rate exposure to just those for transmission in Special Condition 2B.

Consultation question 3: do you have any comments on the proposed modifications to the NGG(NTS) licence?

¹⁰ <https://www.ofgem.gov.uk/publications-and-updates/modification-national-grid-gas-plc-ngg-national-transmission-system-nts-s-gas-transporter-licence-add-dormant-back-stop-meter-provider-last-resort-obligations>