

All interested parties

Email: NGGD.Separation@ofgem.gov.uk

Date: 30 Sep 2016

Dear Colleagues

**National Grid's intended sale of its gas distribution networks:
Decision on conditions precedent prior to hive down**

Background

On 10 November 2015, National Grid Plc (NG) announced the start 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 start 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 assets¹ and licence to a new licensed subsidiary of NG, namely National Grid Gas Distribution Limited (NGGD), and
2. **share sale** – NG then intends to sell a majority of its shares in NGGD.

We² granted conditional³ consent to the transfer of assets by NGG to NGGD on 06 July 2016⁴ under Standard Special Condition (SSC) A27 of the gas transporters licence held by NGG for its distribution network (the Conditional Consent).

We required NGG to provide evidence in writing that it has met the conditions precedent of the Conditional Consent no less than 7 days prior to the nominated hive across date. NGG has indicated to us that the nominated date is 1 October 2016.

This evidence was received on 23 September 2016⁵. Having reviewed NGG's submission on how it has met the relevant conditions precedent and having due regard to our principal objective and other statutory and public law duties, and having considered representations received in the consultation on the proposed licence and asset transfer and in respect of the various related consultations, we are satisfied that the conditions precedent have been met.

¹ Gas distribution assets Gas distribution assets are defined in Appendix 1 of our consent direction issued 6 July 2016.

² 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.

³ The conditions can be separated into conditions precedent, which are conditions that have to be satisfied prior to hive across; and conditions subsequent, which are conditions that have to be satisfied after hive across but prior to any majority share sale.

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

⁵ This letter received from NGG can be found in Annex 2 of this document.

Accordingly, the Authority consents under paragraph 10 of SSC A27 and paragraph 3 of Schedule 3 to the Gas Act 1986 to NGG's proposed disposal of gas distribution assets, as per the proposed disposal, on 1 October 2016, to NGGD.

Annex 1 to this letter sets out the reason for our decision.

Way forward

The Conditional Consent is also subject to conditions subsequent. These conditions are on-going conditions that will need to be met following the hive across and prior to any proposed share sale taking place, as appropriate.

Any questions in reference to this document should be directed to:

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Yours faithfully,



Ian Rowson

Date: 30 September 2016

Associate Partner, RIIO Finance & Investor Relations, Networks Division

Duly authorised on behalf of the Gas and Electricity Markets Authority

Annex 1: Authority's view on each condition precedent (reasons for the Authority's decision to give consent)

For the reasons set out in this Annex, we have concluded that the conditions precedent of the Conditional Consent have been met by NGG.

- a) *The Secretary of State has not directed NGG pursuant to SSC A27 not to proceed with the disposal of, or the relinquishment of operational control over, the Transportation Assets;*

Under paragraph 11 of SSC A27 of NGG's distribution gas transporters' licence (NGG(DN) as transporter licence), NGG is required to notify the Secretary of State at least 60 days in advance of the proposed disposal of transportation assets that comprise a significant part of the gas conveyance system in Great Britain. If the Secretary of State directs NGG, within 30 days of notification, not to proceed with the disposal, NGG must comply with that direction.

NGG notified the Secretary of State on 27th June 2016. The Secretary of State has not directed the company not to proceed with the disposal. As such we consider the condition set out in paragraph 14(a) of the Conditional Consent has been met.

- b) *The Health and Safety Executive ('HSE') has received safety cases in respect of each of NGG (in respect of the National Transmission System) and NGGD and accepted each of those safety cases pursuant to the Gas Safety (Management) Regulations 1996;*

We consider that the condition precedent set out in paragraph 14(b) of the Conditional Consent has been met as we have obtained confirmation from the HSE and NGG that the HSE has now accepted the safety cases of NGG (in respect of the National Transmission System) and NGGD (in respect of the Distribution Networks).

- c) *The Secretary of State has consented in writing to the transfer of NGG(DN)'s Distribution Licence to NGGD pursuant to SSC A45 (Assignment of Licence);*

On 18 July 2016, NGG sent by recorded post to the Secretary of State a notice under SSC A45 of its the NGG(DN) gas transporter licence, requesting permission for the transfer of that licence to NGGD, not sooner than 1 October 2016. The notice is required to be served not less than sixty days prior to the proposed transfer. The notice was delivered to the offices of the Secretary of State on 19 July 2016.

Subsequently, the Secretary of State provided written consent to the transfer of NGG(DN)'s gas transporter licence to NGGD on 24 September 2016 and therefore we consider this condition precedent set out in paragraph 14(c) of the Conditional Consent has been met.

- d) *The Authority has consented (pursuant to section 8AA of the Gas Act 1986) in writing to the transfer of NGG(DN)'s Distribution Licence to NGGD in accordance with the Authority's consent;*

This condition precedent has been met on 30 September 2016 as we have, alongside this document, issued our consent, pursuant to section 8AA of the Act, in writing, to the transfer of NGG(DN)s' gas transporter licence from NGG to NGGD.⁶

⁶ <https://www.ofgem.gov.uk/publications-and-updates/national-grid-s-intended-sale-its-gas-distribution-networks-decisions-statutory-consultations-under-section-8aa-and-section-23-gas-act>

- e) *In the reasonable opinion of the Authority, in light of information submitted by NGG, the allocation of non-transportation assets, obligations and associated operational changes will remain consistent with existing price control arrangements and ongoing commitments;*

In a letter authorised by the board of NGG in a meeting on 8 September 2016, attended by its 2 Sufficient Independent Directors (SIDs), NGG has explained to us how it has allocated assets and established arrangements for separating or sharing activities so that both businesses can maintain those activities and operate within the existing cost envelope. We consider these allocations and arrangements appropriately protect the interests of consumers.

Accordingly, we are satisfied that the condition precedent set out in paragraph 14(e) of the Conditional Consent has been met.

- f) *In the reasonable opinion of the Authority appropriate arrangements relating to industry codes and other industry agreements, including without limitation the Uniform Network Code, have been made, an Individual Network Code has been prepared for NGGD, NGG has taken all reasonable endeavours to ensure that the relevant shippers have signed the new shipper framework agreement, and NGGD has signed the Transporters' Framework Agreement, the agency services agreement (ASA), and the Joint Governance Arrangements Agreement (JGAA); and*

Uniform Network Code (UNC) modifications: Two modifications to the UNC were identified as part of the proposed hive across: Modification 582S and 592S. Both modifications have been approved under UNC "self-governance" criteria with the Authority having reviewed the purpose of each modification and agreed with this approach.

Both Modifications have now been implemented. As such, we are satisfied that this aspect of the condition precedent has been met by 1 October 2016.

Individual Network Code for NGGD: NGG has confirmed on 23 September that an individual Network Code has been prepared for NGGD that will be effective from 05:00 1 October 2016. We will receive a copy from NGGD in accordance with paragraph 3 of SSC A11. As such we consider that this aspect of this condition precedent has been met.

New shipper framework agreements have been signed: We have received several updates of NGG's engagement with all shippers that will be active gas distribution shippers on NGGD's network. These relevant shippers have now all signed this framework agreement so we are satisfied this aspect of the conditions precedent has been met.

NGGD has signed the Transporter's Framework Agreement, ASA and JGAA: NGG have confirmed on 23 September that they have prepared these documents for NGGD and these will become effective from 05:00 on 1 October 2016. As such we consider that this aspect of this condition precedent has been met.

- g) *Any other consent, clearance, permission, authorisation or approval required under statute, the Distribution Licence or otherwise in respect of the proposed hive across of NGG's Transportation Assets to NGGD is obtained.*

NGG has identified all relevant consents, clearances, permission, authorisations and approvals and notified the Authority of these. We are satisfied that all relevant consents either have been granted or we will grant them by 1 October 2016, such that all relevant additional consents will be obtained for both NGG and NGGD. Accordingly, we consider the condition precedent set out in paragraph 14(g) of the Conditional Consent has been met.

Other assurances

As well as the conditions precedent in the Conditional Consent, we also requested additional written assurance from NGG in regards to a number of areas.

We sought assurance from NGG to its ongoing commitment to Xoserve change programmes (FGO⁷ and Nexus⁸) and the Joint Office. This assurance was provided in 23 September letter and as such we are satisfied with this assurance.⁹

Finally, we also requested assurance with respect to the business separation conditions. This is because modifications to NGG's gas transporter licence in respect of the NTS will not come into effect until 26 November 2016¹⁰. One of these modifications requires NGG to deliver the same benefits as would be provided by complete legal separation even where the companies (NGG and NGGD) remain under the same ultimate control. We asked NGG to provide assurance that they undertake to comply with these licence conditions as modified from the point of hive across. They have provided this undertaking in the letter provided 23 September 2016.

In reaching this decision, we have had regard to (among other things) the assurances provided by NGG that it is responsible for identifying all the consents and approvals that it requires and that, in this context (and without limitation), it has sought to ensure that all the necessary approvals and consents have been requested and put in place to ensure full compliance with all the relevant licences from 1 October 2016.

⁷ Funding, Governance and Organisation. We undertook a review of Xoserve's funding, governance and ownership arrangements to ensure that it would be fit for purpose, and provide the required responsiveness and flexibility in the context of future industry changes. In October 2013, after consulting on various options, we decided that a full co-operative governance model should be established for Xoserve. A decision on the modifications needed to establish these new arrangements was then published in April 2016.

⁸ The UK Link system, operated by Xoserve for energy settlements, supply point administration and other functions for the GB gas market, is scheduled to be replaced. Project Nexus is the industry programme aiming to ensure that the replacement systems meet the current and anticipated requirements of market participants

⁹ Please refer to Annex 2

¹⁰ <https://www.ofgem.gov.uk/publications-and-updates/national-grid-s-intended-sale-its-gas-distribution-networks-decisions-statutory-consultations-under-section-8aa-and-section-23-gas-act>