

August 1999

## **BG plc Corporate Restructuring**

### **A Consultation Document and Licence Modifications**



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## 1. Introduction

- 1.1 On 18 June 1999, BG plc announced its intention to initiate a corporate restructuring. The Office of Gas and Electricity Markets (Ofgem), is now seeking views on the regulatory issues associated with the restructuring.
- 1.2 BG plc carries on a number of businesses, some directly and some via subsidiaries. In this document, all these business are collectively referred to as “the existing BG Group”. As part of the proposed restructuring, BG plc will cease to be the ultimate holding company of the existing BG group, and certain businesses currently owned or conducted by BG plc will be moved into separate subsidiaries of a new ultimate holding company (the new “BG Group plc”).
- 1.3 The aim of the proposed restructuring is to contain the regulated gas transportation and LNG storage business of BG plc (“the Transco business”) in a subsidiary of the new BG Group plc, separate from the other BG group businesses. The new BG Group plc would be the ultimate holding company of the other businesses of the existing BG Group which are not related to Transco. BG plc believes that such a corporate structure is more consistent with best practice for groups which comprise a regulated utility business and other interests, as well as being more efficient and increasing shareholder value. BG plc also intends to realign its financial structure, including the issue of further debt by a new intermediate holding company of Transco. The details of the proposed restructuring are explained further in Chapter 2.
- 1.4 Ofgem believes that the principle of separation is to be welcomed: it offers an opportunity to bring greater clarity and transparency to the regulation of Transco by entailing a more precise separation between Transco and the other businesses of the existing BG group. However, the restructuring raises a number of important regulatory issues.

1.5 The restructuring requires consideration by Ofgem in three areas:

- **a Scheme of Arrangement:** this is a court-approved mechanism which allows the restructuring to be effected. Under paragraph 1f(i) of Schedule 2 of BG plc's Public Gas Transporter (PGT) licence, the licence can be revoked if BG plc enters into a scheme of arrangement without the approval of the Director General of Gas Supply ("the Director"). BG plc is therefore seeking the Director's approval to its proposed Scheme;
- **licence modifications:** the Director considers that the restructuring requires modifications to the PGT Licence. These are being proposed under Section 23 of the Gas Act 1986 (the Gas Act), which provides for modification of the Licence with BG plc's consent. The Notice under Section 23 is set out in Annex 2 below; and
- **individual transactions:** in order to effect the proper separation of Transco in this restructuring, it is proposed to transfer individual businesses out of BG plc. The effect of each transfer on the Transco business needs to be considered by Ofgem. Some of these transfers also require the Director's approval in their own right.

1.6 BG plc has sought Ofgem's approval for the Scheme of Arrangement and has, following discussions with Ofgem, agreed in principle to the licence modifications described in Chapter 4 of this document. The principal issues under consideration in this consultation are:

- whether Ofgem should give its general consent to the restructuring by approving the Scheme of Arrangement. A description of the restructuring is contained in Chapter 2, together with a discussion of its implications for the Transco price control, and a summary of the Scheme is set out in Chapter 3;
- whether the proposed licence amendments are appropriate and sufficient to ensure the independence and viability of Transco in the new structure. The issues relating to this are discussed in Chapter 4; and

- whether BG plc's proposals for the separation of individual businesses from Transco are appropriate and whether Ofgem's proposals for monitoring and approving the individual transactions are suitable. The issues relating to this are discussed in Chapter 5.

1.7 Ofgem would welcome all views on these topics (or any other related topics). Responses to this consultation document and the Notice reproduced in Annex 2 should reach Ofgem by 15 September 1999 and be addressed to:

Justin Coombs  
Director of Price Controls  
Office of Gas and Electricity Markets  
Stockley House  
130 Wilton Road  
London  
SW1V 1LQ

1.8 Since Ofgem wishes to conduct this consultation in an open way, we will place all replies to this consultation in our library, except those responses marked "Confidential". If you have any queries concerning this document, Peter John on 0171 932 5941 or Justin Coombs on 0171 932 1605 will be glad to help.

## **2. Background**

2.1 This Chapter describes the restructuring and the regulatory issues arising. BG plc has provided a description of its current corporate structure, the proposed transactions and the corporate structure which would result from the proposed transaction.

### **The businesses of the existing BG Group**

2.2 Members of the existing BG Group presently provide a range of services to gas shippers and final customers within Great Britain. BG plc, trading as Transco, owns and operates the national gas transportation system and, trading as BG Storage, BG plc operates the largest gas storage business in Great Britain.

2.3 The existing BG Group also contains a number of businesses which provide services internally and in some cases externally. These include:

- BG Insurance;
- BG Intellectual Property;
- BG International;
- BG Property;
- BG Technology; and
- the Leasing Group.

2.4 Some of BG plc's businesses are subject to regulation by the Director: Transco operates under the PGT licence, and BG storage is subject to undertakings provided to the Director. BG plc currently operates the LNG storage assets which are also subject to regulation under the PGT Licence.

## **The structure of the existing BG Group**

2.5 A simplified form of the current structure of the existing BG group is shown in the diagrams following paragraph 2.9 below. For the purposes of considering the restructuring, the following should be noted:

- BG plc is presently the ultimate holding company of the existing BG group and is the current PGT licence holder;
- while some activities of the existing BG group are carried on directly by BG plc, others are carried on by subsidiaries of BG plc; and
- some of the existing BG group's financing is raised by specialised subsidiaries of BG plc ("the Finance Companies") and some is raised directly by BG plc or its subsidiaries.

## **Summary of restructuring**

2.6 The key features of BG plc's corporate restructuring are:

- a new ultimate holding company (the new BG Group plc) would be created, as well as two intermediate holding companies, BG Transco Holdings plc and BG Energy Holdings Limited;
- BG plc would become a subsidiary of BG Transco Holdings. BG plc would then be renamed "BG Transco plc" and any subsidiaries of BG plc at that time would become subsidiaries of the new BG Transco plc. BG Transco plc will be the holder of the PGT licence. (BG Transco plc and its subsidiaries are hereafter referred to as "the new BG Transco plc group".);
- non-Transco businesses would be transferred from the new BG Transco plc group into BG Energy Holdings via individual transactions; and



- a regulatory ringfence would be created around Transco (i.e. around the regulated gas transportation and LNG storage business within BG Transco plc) by the licence modifications proposed in Chapter 4.

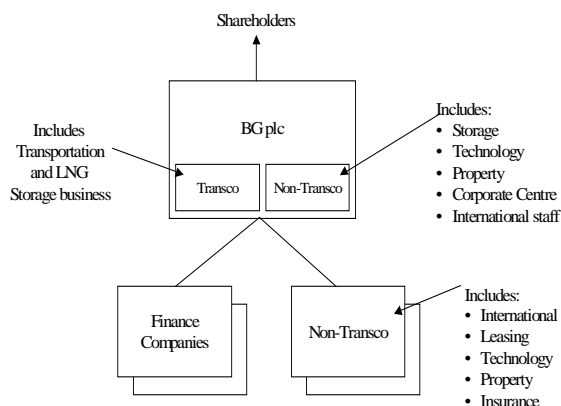
2.7 Following the restructuring, it is proposed that the financing of the new BG group would continue to be carried out both by the Finance Companies within the new BG Transco plc group and other companies, including BG Transco Holdings, which is planning to issue bonds to BG plc's existing shareholders. These bonds will form part of the consideration for existing shares, and are expected to amount to between £1-2 billion.

2.8 After this process is complete, the new BG Group plc will own all the share capital in:

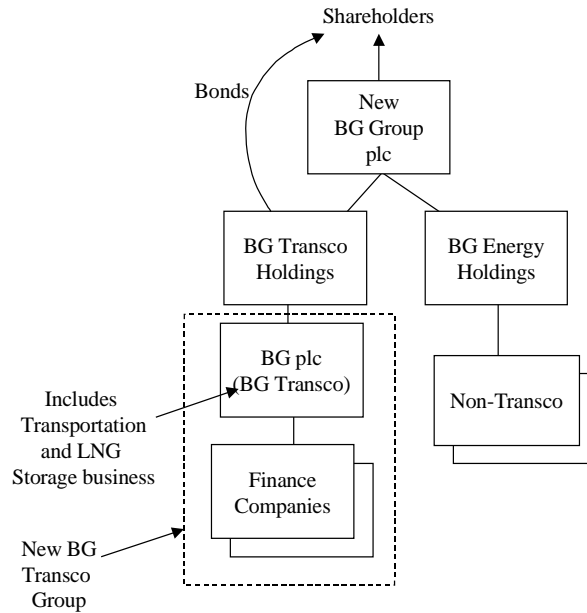
- BG Transco Holdings, the immediate holding company of BG Transco plc (formerly BG plc). BG Transco plc will also own the Finance Companies; and
- BG Energy Holdings, the immediate holding company of the existing BG group businesses other than the new BG Transco plc group businesses.

2.9 The following diagrams illustrate the current and proposed structure and the terms used to describe these businesses and groups of businesses in this document.

*Current group structure (the existing BG Group):*



*Proposed final structure:*



## Ofgem's role

2.10 BG's proposed restructuring has the potential to improve the transparency and clarity of regulation to the ultimate benefit of customers. However, it also raises potential risks which Ofgem needs to address. The Director set out various regulatory issues arising from the proposed restructuring more fully in a letter to BG plc which was sent prior to the announcement of the proposed restructuring. That letter is set out in Annex 5 to this document. In summary, there are three potential risks:

- Transco might lack the resources and finance necessary for it to carry out its licensed activities and fulfil its obligations under the Gas Act and its licence. For example, under the new corporate structure, the holding companies could undermine the financial position of Transco through the payment of inappropriate dividends from Transco, or other transfers of funds or assets. Where businesses are transferred to new subsidiaries, the division of assets and liabilities might leave Transco with insufficient assets or inappropriate liabilities;

- the new holding companies of Transco may be able to undermine Transco's fulfilment of its obligations under the Gas Act and its licence, or may refuse to co-operate with Ofgem in its regulation of Transco, for example by refusing to provide relevant information to Ofgem; and
- where businesses which are ancillary to regulated activities, as referred to in the Act, are moved out of BG plc, these businesses could gain an undue competitive advantage or may need to be subject to continuing regulation.

2.11 Ofgem proposes to address the first two of the risks identified above through modifications to the PGT licence to create a regulatory ring fence around the PGT licensee. The proposed modifications are discussed in Chapter 4. Aspects of the first risk, as well as the third risk, will be addressed via processes to approve the movement of individual businesses out of BG plc. These processes are discussed in Chapter 5.

### **Impact on the Transportation and LNG Storage Price Control**

2.12 Transco's charges are currently regulated by an RPI-X price control. The current control is expected to operate from 1 April 1997 until 31 March 2002. Ofgem has considered whether the proposed restructuring has any implications for this price control. The transfer of ancillary businesses might involve businesses currently providing services which are included in the Transco price control, and which might therefore involve dividing or adjusting the current price control. This would be the subject of separate consultation. This section considers whether the proposed restructuring might have any other implications for Transco's price control.

2.13 The Scheme of Arrangement involves replacing part of the group's equity capital by bonds issued by BG Transco Holdings. BG plc believes that, because debt financing involves a lower cost of capital than equity financing, this will allow it to reduce the weighted average cost of capital for BG Transco Holdings. Ofgem believes that regulatory consistency helps to lower the cost of capital, and therefore price controls should be re-opened only in exceptional circumstances.

Ofgem does not believe that BG plc's proposed restructuring represents such circumstances, still less the issue of additional bonds by BG Transco Holdings.

- 2.14 If the issue of additional bonds allows Transco to reduce its cost of capital below that envisaged when setting the current price control, this should be treated in the same way as any other efficiency gain by Transco. Transco should be allowed to benefit from the full cost reduction throughout the period of the current price control. Ofgem will then take account of any reduction in Transco's cost of capital when deciding on the appropriate return on regulatory assets to be used when setting the next price control. Customers may then benefit from any reduction in Transco's cost of capital.
- 2.15 Ofgem has also considered whether approval of the Scheme of Arrangement might raise expectations regarding the conduct of future price control reviews. Since the Scheme involves the issue of new debt by BG Transco Holdings, which can be financed only via dividend payments from Transco, approval of the Scheme might be seen as approving the resulting level of gearing for the Transco business. Ofgem does not accept that approval of the scheme should raise such expectations, particularly given that the new debt is issued by the intermediate holding company, not by the Licensee itself. Ofgem will not directly regulate BG Transco Holdings, and its primary concern in this context is the continuing ability of the PGT licence holder to finance its regulated business. Subject to the implementation of the measures proposed in this document, Ofgem believes that this ability should be maintained but takes no other view regarding the efficiency of Transco's new financing arrangements, which will be considered at the time of the next price control review.
- 2.16 The current price control is based, amongst other factors, on a regulatory asset value for the Transco business. This value is derived by assigning a proportion of the market capitalisation of the former British Gas plc on 31 December 1991 to the Transco business. The market value of BG plc's non-Transco businesses (and businesses which may in future be unbundled from Transco) can be relevant to this assignment. Although the Scheme involves the transfer of certain businesses out of BG plc for certain book values, these values are not necessarily market values, and therefore will not necessarily be relevant in future assessments of

Transco's regulatory value. More generally, approval of the scheme or any transactions does not involve any comment by Ofgem on its assessment of the future regulatory value of Transco.

2.17 In reply to the letter set out in Annex 5, BG plc has acknowledged the distinction between any approval of the Scheme or any individual transactions, on the one hand, and any position the Director may take with respect to any aspect of the next price control review, on the other hand.

### **3. The Scheme of Arrangement**

#### **Purpose of the Scheme**

- 3.1 The form of the Scheme of Arrangement which BG plc intends to ask the Director to approve is set out in Annex 1. It requires approval from the Companies Court under Section 425 of the Companies Act 1985. Under Schedule 2 Section 1f(i) of the PGT Licence, the licence can be revoked if BG plc does not obtain approval from the Director for any Scheme of Arrangement which it enters into.
- 3.2 The purpose of the Scheme is to provide for the reduction in BG plc's share capital to be achieved by the cancellation of shares and their reissue to BG Group plc. In consideration, shareholders will receive shares in BG Group plc and bonds issued by BG Transco Holdings plc (and cash in place of fractional entitlements to bonds and shares).

#### **Outline of the Scheme**

- 3.3 The following is a summary of the sections of the Scheme document:
- Sections 1 and 2 of the Scheme documents have the effect of cancelling the existing shares of BG plc which are then reissued to the new BG Group plc followed by the issue to the shareholders of new shares in the new BG Group plc and bonds in BG Transco Holdings. The position of the Government as special shareholder is a matter for continuing discussion between BG plc and the Secretary of State for Trade and Industry;
  - Sections 3 and 4 describe the arrangements for the issue of new shares and new bonds;
  - Section 5 covers the logistics of sending certificates, bond documents and payments in respect of any fractional entitlements to shares or bonds to BG plc's shareholders;

- Section 6 provides that all share certificates in respect of existing shares in BG plc are no longer valid following the Scheme;
- Section 7 provides for all mandated payments and instructions to BG plc to be transferred to the new BG Group plc;
- Section 8 is likely to contain provisions requesting the Court's consent in the event that aspects of the restructuring are considered otherwise to be contrary to section 151 of the Companies Act 1985 (relating to financial assistance).
- Sections 9, 10 and 11 deal with the date at which the Scheme will take effect, and with the method for modifying the Scheme.

### **Views sought**

3.4 Ofgem is currently of the opinion that it should approve the Scheme of Arrangement, for the following reasons:

- Ofgem's approach to regulation has been to allow BG plc the maximum commercial freedom, provided that Ofgem's statutory duties are fulfilled;
- providing the licence modifications proposed in this document are made, nothing in the Scheme of Arrangement appears to jeopardise BG plc's fulfilment of its duties under the Gas Act or its licence; and
- to refuse to approve this Scheme of Arrangement could significantly add to the regulatory risk which the market attributes to BG plc, thereby raising its cost of capital.

3.5 Ofgem is not currently aware of any regulatory issues arising from the Scheme of Arrangement itself (although issues arise from the movement of individual businesses which are discussed in Chapter 5 of this document).

3.6 *Ofgem seeks views on whether it should approve the Scheme of Arrangement.*

## 4. Licence Amendments

### Introduction

- 4.1 Under Section 23 of the Gas Act, the Director may propose modifications to the PGT Licence. Annex 2 contains the Notice under Section 23 of the Gas Act setting out the Director's proposed amendments. The Director must allow at least 28 days for consultation on these proposals before they can be implemented. In proposing such modifications, the Director must have regard to his duties under sections 4 and 4A of the Gas Act. The Director is required to state the proposal to make the modifications, set out the effects of the modifications, and give reasons why the modifications are necessary.
- 4.2 Modifications to the PGT licence are necessary for a number of reasons as a result of this restructuring, but above all because the licence will be held by a subsidiary, BG Transco plc, rather than the parent company. The proposed licence conditions (collectively referred to as the "ringfence") would be similar to those imposed on public electricity suppliers with similar corporate structures, except for changes required because of particular circumstances relating to Transco or where Ofgem considers it may be in the public interest to strengthen the existing ringfence. This Chapter comprises an analysis of the effects of, and reasons for proposing, each of the new conditions or amended conditions set out in Annex 2.

### **Special Condition 1: New definitions required**

- 4.3 This modification defines new terms used in the licence as a result of the modifications described below.

### **Special Condition 2: Restriction on activity and financial ring fencing**

- 4.4 In order to improve regulatory clarity and transparency, Ofgem wishes to prevent the Licensee from carrying on any activities other than the Transco business. It is also important that the Director can restrict the use to which resources are put



when those resources are funded by revenues generated through the transportation price control.

- 4.5 Currently Special Condition 8A of the PGT licence requires BG plc to appoint an officer as the Managing Director of Transco ("MD Transco") and to provide that officer with certain staff and resources. Paragraph 3(1) of Special Condition 8A prevents those staff and resources from being used for any activity other than the transportation and LNG storage business (except with the Director's consent). That condition is designed to prevent resources which have been funded from transportation revenues from being diverted to other uses. The proposed Special Condition 2 is designed to achieve the same purpose with greater effect. It prohibits the Licensee from undertaking any business not directly related to its licensed activities. However, whereas Condition 8A referred to the staff and resources of the MD Transco, the proposed Special Condition 2 will refer to all the activities of the Licensee, BG Transco plc. This should create a clearer, more transparent distinction between the activities of Transco and the rest of the BG group.
- 4.6 Whilst it is intended that the BG Transco plc will in the future limit its activities to the Transco business, there will be a transitional period after the new conditions have come into force but before all non-Transco businesses have been moved out of BG Transco plc. For this reason paragraph 3 of the proposed Special Condition 2 allows the licensee to continue carrying on its existing non-Transco activities providing it is using reasonable endeavours to transfer those businesses out of BG Transco plc.
- 4.7 BG plc currently guarantees financial and other obligations of some of its subsidiaries and has entered into arrangements containing cross-default provisions in the ordinary course of its business. Ideally, all such liabilities should be moved out of Transco if they are not directly related to Transco's business. However, BG plc has argued that it is not possible immediately to move all such guarantees out without unreasonable expense or without the consent of third parties which may not be forthcoming. Accordingly, paragraph 5 allows some guarantees to remain within BG Transco plc provided that a counter-indemnity is provided by another member of the BG group outside of the ringfence. In order to minimise BG

Transco plc's exposure to risks arising from outside the Transco business, this licence condition requires that the party which is providing the counter-indemnity to Transco retains at all relevant times an investment-grade credit rating.

4.8 Paragraph 6 contains a de minimis provision which allows BG Transco plc to carry on other activities provided the total turnover of these activities is less than 2.5% of the turnover of the transportation and LNG storage business, and the aggregate investment in the de minimis businesses represents less than 2.5% of BG Transco plc's share capital and reserves. The activity must also employ the assets or staff of the Transco business. Ofgem accepts that there may be benefits to customers if Transco can use its existing resources in new activities. However, Ofgem wishes to limit the potential risks generated by such diversification, and restrict BG Transco plc from carrying on activities completely unrelated to the Transco business. Given that de minimis activities would involve the use of assets or staff of Transco, which may have been funded through transportation revenues, Ofgem may wish to take account of the revenues generated by these de minimis services in future price control reviews.

4.9 *Ofgem invites views on whether the proposed Special Condition 2 will be effective at:*

- *providing regulatory clarity and transparency for the Transco business;*
- *preventing Transco from retaining inappropriate liabilities; and*
- *preventing Transco's resources from being used for inappropriate activities.*

### **Special Condition 3: Sufficiency of resources**

4.10 Ofgem will need to ensure that Transco continues to possess the necessary resources and finance to carry out its licensed activities and to comply with its obligations under the Gas Act and its Licence. Currently, paragraph 2 of Special Condition 8A requires BG plc to provide the MD Transco with the staff, resources and finance necessary for it to comply with Section 9(1)(a) of the Act. It also requires BG plc to report to the Director from time to time on its compliance with this requirement.

- 4.11 The proposed new Special Condition 3 requires the Licensee to ensure that it has sufficient management and financial resources to carry on its licensed activities and to comply with its obligations under the Act and its Licence, and to certify annually to the Director to this effect. The Licensee is also required to inform the Director should it be likely to breach this requirement. This amendment also requires that the Licensee procure from its ultimate holding company a legally enforceable undertaking that the ultimate holding company and its subsidiaries (other than the Licensee and its subsidiaries) will refrain from any action which would be likely to cause the Licensee to breach its obligations under the Gas Act or its Licence.
- 4.12 Since the Licensee will now be a subsidiary of a wider group, there might be a danger that the holding company could extract dividend payments from Transco which would undermine its ability to finance its licensed activities, or that it could undermine the Licensee's compliance with its regulatory obligations in some other way. The licence therefore needs to have a sanction to prevent this from happening. The proposed Special Condition 3 would therefore place a requirement on the Licensee, before paying a dividend, to certify that it is in compliance in all material respects with the specified parts of the ringfence. Specifically, the amendment prevents the payment of a dividend where the Licensee is in material breach of obligations imposed by Special Conditions 2, 3 or 4, or certain provisions of amended Standard Conditions 16 and 25, or where the payment of a dividend would reasonably foreseeably cause the Licensee to materially breach any such obligations.
- 4.13 Lastly, the proposed condition would prohibit the provision of services from other parts of the BG Group if they involve a cross-subsidy.
- 4.14 *Ofgem invites views on whether this licence condition will be effective at ensuring that:*
- *Transco possesses the resources and finance necessary to carry out its licensed activities and meet its statutory obligations;*
  - *Transco does not pay dividends which will undermine its financial position (and whether the restriction of dividend payments if Transco is in breach of Amended Standard Condition 16 is appropriate); and*

- *the holding company will not undermine Transco's compliance with its licence and Gas Act obligations*

#### **Special Condition 4: Investment-grade credit rating for corporate debt**

4.15 Special Condition 3 above is intended to ensure that Transco will possess the financial resources necessary to carry out its licensed activities. However, it is impractical and inappropriate for Ofgem to monitor the financial resources of the company on a day-to-day basis. One way to ensure continuing compliance with this requirement is to require the Licensee to maintain an investment-grade credit rating. This should ensure that the Licensee has access to a wide range of sources of finance, which are readily available at reasonable cost. The proposed Special Condition 4 would impose this requirement on the Licensee as issuer of corporate debt.

4.16 A similar requirement is currently contained in the licences of some public electricity suppliers (PESs), where mergers have created similar corporate structures to that now proposed for BG plc and raised similar issues. In the case of PESs, the requirement has been for the *debt* issued by the licensee to maintain an investment-grade rating. This reflected previous practice by credit-rating agencies, which have usually rated individual bond issues rather than the issuer itself. However, it is now possible for a company to obtain a rating as an issuer, instead of, or in addition to, a rating for its debt. OFFER's decision document on PES licence modifications in February this year discussed the merits of issuer ratings.<sup>1</sup> It seems to Ofgem that when monitoring the financial integrity of a regulated company it is more appropriate to require an issuer rating, rather than a rating for individual debt issues. The requirement in the proposed condition therefore refers to an issuer rating (and Ofgem may use the same approach in future PES licence amendments).

4.17 Ofgem has considered whether the requirement to maintain an investment-grade credit rating might restrict the extent to which the Director could achieve a

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<sup>1</sup> *Modifications to Public Electricity Supply Licences Following Takeover: Response to Consultation*, OFFER, February 1999.

reduction in Transco's charges when reviewing its price control. There are two potential circumstances where it might be argued that this problem could arise.

- 4.18 The first arises because, when setting a price control, Ofgem normally has to estimate Transco's minimum cost of capital. This estimate will be based on an assessment of the optimum level of gearing for Transco; that is, the level of gearing which would minimise Transco's cost of capital. In theory, this level of gearing might be higher (implying more debt) than is consistent with an investment-grade credit rating. It could then be argued that to set a price control based on such assumptions would require Transco to breach the proposed Special Condition 4.
- 4.19 However, Ofgem considers that in practice it is unlikely that the optimum level of gearing for Transco would conflict with the requirement to maintain an investment-grade credit rating. This is because the cost of debt (the rate of interest to be paid) rises sharply between bonds which carry the lowest investment-grade rating and those which are rated at the next level below. In any case, the rating of the issuer does not constrain the rating of individual issues, which could be at a higher or lower level depending, for instance, on the degree of subordination of the debt. The restriction on the issuer's rating does not in practice constrain its behaviour in terms of optimal capital cost.
- 4.20 The second potential problem would arise if, when the Director makes proposals for a price reduction, the Licensee argued that this price level would lead to a reduction in cash flows which would prevent Transco maintaining an investment-grade credit rating.
- 4.21 However, the Director is already required to ensure that the Licensee is able to finance the carrying on of its licensed activities. Providing that the first circumstance discussed above did not arise, so Transco's optimum level of gearing was consistent with an investment-grade credit rating, Ofgem would not propose a price reduction unless it believed that the lower prices would still allow Transco to finance its licensed activities at a level of gearing which allows it to maintain an investment-grade credit rating. If Transco argued that the cash flows arising from the Director's proposals were not consistent with an investment-grade

credit rating, Transco would in effect be arguing that Ofgem had over-estimated the potential for cost savings by Transco. Unless this difference of view could be resolved, Transco's price control would have to be referred to the Competition Commission for investigation.

4.22 In reaching its conclusions, the Competition Commission would either accept Ofgem's view that the proposed price control would allow Transco to finance its licensed activities at a level of gearing consistent with an investment-grade credit rating; or it would conclude that the Director had over-estimated the potential for cost savings. Provided that the optimal level of gearing is consistent with an investment-grade credit rating, the requirement to maintain this rating would not impact on the Commission's conclusions. In the absence of this requirement, the Commission would still have to assess whether the Director's proposals would allow Transco to finance its licensed activities at the level of gearing that would minimise Transco's cost of capital.

4.23 Ofgem takes the view that a requirement on the Licensee to maintain an investment-grade credit rating does not place any new restriction on the Director's freedom of action. The Director already has a duty to secure that Transco can finance its licensed activities. The proposed Special Condition 4 would translate this into an obligation on the Licensee to maintain an investment-grade credit rating. Taken together with proposed Special Condition 3, this imposes an obligation on Transco's holding company not to take any action which would leave Transco insufficiently financed to maintain this rating, which Ofgem believes is a necessary protection in the light of the impracticality of continuous financial monitoring.

4.24 *Ofgem invites views on whether the requirement on BG Transco plc to maintain an issuer investment-grade credit rating is appropriate and will be effective at reinforcing the requirements of proposed Special Condition 3.*

#### **Amended Standard Condition 16: Provision of Information to the Director**

4.25 Given the proposed new corporate structure, Ofgem will need to ensure that the ultimate holding company of the Licensee and its subsidiaries will co-operate with

Ofgem in its regulation of the Licensee. In particular, Ofgem may need to obtain information from the ultimate holding company or other members of the group.

4.26 The proposed amendment to Standard Condition 16 requires the Licensee to procure from its ultimate holding company an undertaking that it and its subsidiaries (other than the Licensee and its subsidiaries) will furnish such information to the Licensee as the Director may require, and prohibits the Licensee from entering into any agreements or arrangements with its ultimate holding company, or with other subsidiaries of its ultimate holding company, if there is a breach of this condition (save with the Director's consent).

4.27 *Ofgem invites views on whether this proposal will ensure that Ofgem has access to the information necessary to fulfil the Director's duties.*

**Amended Standard Condition 25: Disposal of transportation and LNG storage assets and cash ring fence**

4.28 Paragraph 8 of proposed Special Condition 3 above regulates the payments of dividends. As explained above, amongst other things, this is intended to prevent transfers of funds out of the Licensee which would undermine its ability to undertake its licensed activities. However, there are other ways in which funds could be removed from the Licensee; for example, through loans to other group companies.

4.29 The proposed amendment to Amended Standard Condition 25 would prohibit the Licensee from undertaking any indebtedness, creating any security or interest in any of its assets, or giving any guarantees, except for the purpose of the Transco business and on an arm's-length basis on normal commercial terms. The proposed amendment would also prohibit Transco (except with the consent of the Director) from entering into other transactions with related persons which might remove funds or assets from the Licensee, unless they are for the purpose of the Transco business and on an arm's-length basis on normal commercial terms. This would effectively preclude the Licensee from entering into any transaction with a related person unless it would be equally willing to enter into a similar transaction and on similar terms with an unrelated party of comparable standing.

## Special Condition 8A

4.30 Ofgem considers that the conditions described above create a ringfence that will provide greater safeguards than are currently provided by Special Condition 8A of Transco's licence. Accordingly, Ofgem believes that Special Condition 8A should be deleted as part of the licence modifications. This deletion requires a number of consequential modifications, particularly to Amended Standard Condition 2, resulting from the need to remove references to the MD Transco.

## Views sought

4.31 Ofgem welcomes views on the licence amendments set out in Annex 2 and summarised above, and in particular:

- *whether the licence, as amended, will constitute a sufficient financial and physical ringfence for the regulated business;*
- *whether Special Condition 8A is redundant given the provisions in the ringfence above; and*
- *whether any additional conditions should be added to Transco's licence.*



## 5. Individual Transactions

5.1 As part of the restructuring, the BG group proposes transferring certain businesses to a new subsidiary BG Energy Holdings. For regulatory purposes, these transfers fall into two types:

- transfers of ancillary businesses, where it will be important to ensure that the ringfence around Transco is properly maintained but, given the Directors duties under the Act, may also raise competition issues relating to the businesses themselves; and
- transfers of non-ancillary businesses, where the only regulatory concern is the maintenance of the Transco ringfence.

For example, Ofgem considers that the BG Storage business is an ancillary business within these definitions.

### Ancillary businesses

5.2 The movement of ancillary businesses out of BG plc raises a number of potential issues:

- the activities may be covered by Transco's price control, or form part of its regulatory asset base, either of which might then have to be adjusted;
- Ofgem will need to ensure that the terms on which the business leaves BG plc (potentially including the values placed on transferred assets) does not confer any undue competitive advantage on the transferred business, and consider any impact on the Director's exercise of his powers under competition legislation; and
- it may be necessary to amend the PGT licence.

- 5.3 For these reasons, Ofgem proposes that where an ancillary business is transferred, this should normally be subject to a separate consultation. The issues outlined above are therefore not considered further in this document.
- 5.4 The transfer of ancillary businesses also raises issues concerned with the Transco ringfence which are considered in the following section.

### **Non-ancillary businesses**

5.5 BG plc has provided to Ofgem a list of businesses which it proposes to transfer as part of the restructuring and which it considers to be non-ancillary. Ofgem is consulting on the transfer of those businesses in this document.

5.6 The non-ancillary businesses which would be transferred as part of this transaction include:

- BG Technology;
- BG Intellectual Property;
- BG Property;
- BG International;
- The Leasing Group; and
- BG Insurance.

5.7 BG plc has provided a description of each of these businesses in Annex 4 below.

5.8 Ofgem has agreed a process with BG plc to ensure that the terms of their transfer are appropriate. This process is outlined in Annex 3. This process will allow Ofgem to establish whether or not the businesses to be moved are, or are not, ancillary as defined above and whether BG plc's proposals are acceptable.

## **Regulatory issues arising from the movement on non-ancillary businesses**

- 5.9 The principal risk from the movement of non-ancillary businesses from BG plc to other parts of the group is that inappropriate assets could leave Transco, or that inappropriate liabilities could be left with the Transco business. Specifically, Ofgem will wish to ensure that assets which form part of Transco's regulatory asset base are not removed, and that Transco does not incur or retain inappropriate liabilities attributable to conduct arising from actions of the transferred business or the terms of its transfer.
- 5.10 The process explained in Annex 3 is designed to elicit the information necessary for Ofgem to satisfy itself that the movement of assets and liabilities is appropriate. In addition, the proposed licence conditions above will regulate relationships between these businesses and Transco. In particular, the proposed Special Condition 2 will require the new holding company, or one of its non-Transco subsidiaries, to provide a counter indemnity against certain liabilities left with Transco.
- 5.11 Ofgem considers that, provided the agreed process is followed, all relevant assets (and where possible, contingent liabilities) are moved with each business, and confirmation is received that these businesses will respect the conditions of the ringfence, where relevant and practical, before the ringfence comes into force, there is no reason to prevent the transfer of non-ancillary businesses to BG Energy Holdings.
- 5.12 The non-ancillary businesses will not be subject to direct regulation by Ofgem after they are transferred. Ofgem therefore considers that, providing the division of assets and liabilities between these businesses and Transco is appropriate, it need have no opinion on the accounting value at which these assets are transferred into BG Energy Holdings.

## Views sought

5.13 *Ofgem seeks views on the movement of businesses from BG plc into BG Energy Holdings, and in particular:*

- *whether the distinction between ancillary and non-ancillary businesses described above is appropriate;*
- *whether the businesses listed above are non-ancillary;*
- *whether Ofgem has correctly identified the potential regulatory issues arising from the movement of ancillary and non-ancillary businesses; and*
- *whether Ofgem's proposed procedures for the movement of these businesses will be appropriate and effective.*

**Annex 1: The Form of the Scheme of Arrangement BG plc intends to ask  
the Director to Approve**

**IN THE HIGH COURT OF JUSTICE  
CHANCERY DIVISION  
COMPANIES COURT**

**● of 1999**

**IN THE MATTER OF BG PUBLIC LIMITED COMPANY**

**and**

**IN THE MATTER OF THE COMPANIES ACT 1985**

**SCHEME OF ARRANGEMENT**

**(under Section 425 of the Companies Act 1985)**

**between**

**BG PUBLIC LIMITED COMPANY**

**and**

**THE HOLDERS OF THE ORDINARY SHARES  
(as hereinafter defined)**

**[CONSIDER WITH SPECIAL SHAREHOLDER WHETHER OR NOT IT WILL BE A  
PARTY]**

**PRELIMINARY**

(A) In this Scheme of Arrangement, unless the context otherwise requires, the following expressions shall bear the following meanings:

**"BG"** means BG Public Limited Company

**"BG Group"** means BG Group plc, incorporated in England and Wales with registered number 3690065, [the proposed new holding company of BG]

**["Bond Documents"]** [means certificates/receipts issued by ●

	representing entitlements to BG Transco Holdings Bonds]
<b>"Bonds"</b>	means the [Coupon] bonds due ● in BG Transco Holdings plc,
<b>"business day"</b>	means a day (excluding Saturday or Sunday) on which banks generally are open for business in the City of London for the transaction of normal banking business
<b>"in certificated form"</b>	a share or other security which is not in uncertificated form,
<b>"Court"</b>	means the High Court of Justice in England and Wales,
<b>"Court Meeting"</b>	means the meeting of the holders of Ordinary Shares convened by order of the Court pursuant to section 425 of the Companies Act 1985 to consider and, if thought fit, approve this Scheme and any adjournment thereof,
<b>"CREST"</b>	means the system for the paperless settlement of trades in securities and the holding of uncertificated securities operated by CRESTCo in accordance with CREST Regulations,
<b>"CREST Regulations"</b>	means the Uncertificated Securities Regulations 1995 (SI 1995 No. 95/3272),
<b>"CRESTCo"</b>	means CRESTCo Limited,
<b>"Effective Date"</b>	means the date on which this Scheme becomes effective in accordance with its terms,
<b>"Hearing Date"</b>	means the date on which the Order is made,
<b>"holder"</b>	means a registered holder and includes any person(s) entitled by transmission,
<b>"New Shares"</b>	means ordinary shares of ● pence each in the capital of BG Group,
<b>"Official List"</b>	means the Official List of the London Stock Exchange,
<b>"Order"</b>	means the order of the Court sanctioning this

	Scheme,
<b>"ordinary shares"</b>	means ordinary shares of 1 <sup>2</sup> / <sub>15</sub> pence each in the capital of BG
<b>"Ordinary Shares"</b>	means the ordinary shares in the capital of BG <ul style="list-style-type: none"> <li>(a) in issue at the date of this Scheme</li> <li>(b) (if any) issued thereafter and prior to the Voting Record Time, and</li> <li>(c) (if any) issued at or after the Voting Record Time and before 6.00 pm on the last business day before the Hearing Date on terms that the holder shall be bound by this Scheme,</li> </ul>
<b>"Ordinary Shareholders"</b>	means holders of Ordinary Shares as appearing in the register of members of BG at the Scheme Record Time,
<b>"Scheme Record Time"</b>	means 6.00 pm on the business day immediately preceding the Effective Date,
<b>"Scheme"</b>	means this Scheme of Arrangement in its present form or with or subject to any modification, addition or condition approved or imposed by the Court,
<b>[Include Special Share definitions only if required]</b>	
<b>["Special Share"</b>	means the special rights redeemable preference share of £1 in the capital of BG]
<b>["Special Shareholder"</b>	means the Secretary of State for Trade & Industry]
<b>"uncertificated" or "in uncertificated form"</b>	means recorded on the relevant register as being held in uncertificated form in CREST and title to which, by virtue of the CREST Regulations, may be transferred by means of CREST,
<b>"US"</b>	means the United States of America, its territories and possessions,
<b>"Voting Record Time"</b>	means ● on ● 1999, or, if the Court Meeting is adjourned, 48 hours before the time fixed for the adjourned Court Meeting

- (B) The authorised share capital of BG at the date of this Scheme is £● divided into ● ordinary shares of 1 2/15 pence each, of which ● have been issued and are credited as fully paid and the remainder are unissued, [B Shares/Deferred Shares] **[and one Special Share which has been issued and is credited as fully paid].** **[Consider with Special Shareholder whether this will have been redeemed].**
- (C) BG Group was incorporated in England and Wales as a private limited company on 30 December 1998 under the name Scentoffice Limited with registered number 3690065. By virtue of a written resolution dated ● 1999 the name of the Company was changed to BG Group Limited and it was re-registered as a public limited company on ● 1999.
- (D) The authorised share capital of BG Group at the date of this Scheme is £● divided into ● New Shares, all of which have been issued and are credited as fully paid, and ● Redeemable Preference Shares of £1 each, all of which have been issued and are paid up to the extent of ● pence per share. Subject to the approval of the holders of ordinary shares at an Extraordinary General Meeting of BG to be held on ●, the authorised share capital of BG Group will be increased by the creation of ● New Shares of ● each **[Consider treatment of Special Share].**
- (E) The purpose of this Scheme is to provide for the cancellation of the Ordinary Shares **[and the Special Share - consider with Special Shareholder]** in consideration of the allotment by BG Group of New Shares and the [transfer] by BG Group of Bonds to each holder of Ordinary Shares on the register of BG as at the Scheme Record Time **[and of the allotment by BG Group of the New Special Share to the Special Shareholder - consider with Special Shareholder]** .
- (F) BG Group has agreed to appear by Counsel on the hearing of the petition to sanction this Scheme[, to consent thereto] and to undertake to the Court to be bound thereby and to execute and do or procure to be executed and done all such documents, acts and things as may be necessary or desirable to be executed or done by them for the purpose of giving effect to this Scheme. **[Consider with Special Shareholder whether or not it will be a party.]**



## THE SCHEME

### 1 Cancellation of Ordinary Shares

- (a) The share capital of BG shall be reduced by cancelling and extinguishing the Ordinary Shares **[and the Special Share - consider with Special Shareholder]**.
- (b) Forthwith and contingently upon the said reduction of capital taking effect
  - (i) the share capital of BG shall be increased to its former amount by the creation of such number of ordinary shares of ● each as shall be of an aggregate nominal amount equal to the aggregate nominal amount of the Ordinary Shares cancelled pursuant to sub-clause (a) of this Clause [? amount of Special Share], and
  - (ii) BG shall apply the credit arising in its books of account as a result of such reduction of capital in paying up, in full at par, the new ordinary shares created pursuant to Clause 1(b)(i) of this Scheme and shall allot and issue the same credited as fully paid up at par to BG Group and/or its nominees.

### 2 Consideration for the cancellation of the Ordinary Shares and the Special Share

- (c) In consideration of the cancellation of the Ordinary Shares and the allotment and issue of the new ordinary shares as provided in Clause 1(b)(ii) of this Scheme, BG Group shall (subject to the remaining provisions of this Clauses and to the provisions of Clauses 3, 4 and 5 of this Scheme):
  - (i) allot and issue (credited as fully paid) New Shares to the Ordinary Shareholders, on the following basis:
    - for every ● Ordinary Shares held at the Scheme Record Time, ● New Shares and so in proportion for any other number of Ordinary Shares held, and
  - (ii) [transfer] entitlements to Bonds to the Ordinary Shareholders on the following basis:
    - for every ● Ordinary Shares held at the Scheme Record Time, [one] Bond.
- (d) **[Consider provisions relating to Special Share, if required]**
- (e) Fractions of New Shares shall not be allotted and fractions of BG Transco Holdings Bonds shall not be [transferred] to Ordinary Shareholders but shall be aggregated and sold in the market as soon as practicable following the Effective Date and the net proceeds shall be paid to the persons entitled thereto. **[Consider if language appropriate for Bonds and need to provide for Bond entitlements of less than one Bond]**

### **3 Allotment and issue of New Shares and the New Special Share**

- (f) The New Shares to be issued pursuant to Clause 2(a) above shall rank [pari passu in all respects with all other New Shares in issue on this Effective Date] in full for all dividends or other distributions made, paid or declared after the Effective Date on the ordinary share capital of BG Group.
- (g) **[Consider provisions relating to Special Share, if required]**
- (h) The provisions of Clause 2 relating to the allotment and issue of New Shares shall be subject to any prohibition or condition imposed by law. Without prejudice to the generality of the foregoing, if, in respect of any holder of Ordinary Shares with a registered address outside the United Kingdom [or who is a citizen, resident or national of a jurisdiction outside the United Kingdom], BG Group is advised that the allotment and issue of New Shares pursuant to Clause 2 would or may infringe the laws of any jurisdiction outside the United Kingdom or would or may require BG Group to observe any governmental or other consent or any registration, filing or other formality then BG Group may determine that no New Shares shall be allotted or issued to such holder under Clause 2, but shall instead be allotted to a nominee appointed by BG Group, as trustee for such holder, on terms that the nominee shall, as soon as practicable following the Effective Date, sell the New Shares so allotted at the best price which can reasonably be obtained and shall account for the [ ] proceeds of such sale [ ] by sending a cheque or warrant to such Ordinary Shareholder in accordance with the provisions of Clause [5(a)] of this Scheme. None of BG, BG Group or the nominee shall have any liability for any loss arising as a result of the timing of terms of this such sale.
- (i) Not later than ● business days after the Effective Date, BG Group shall:
  - (iii) allot and issue all of the New Shares which it is required to allot and issue pursuant to Clause 2 of this Scheme and, in the case of Ordinary Shares which at the Scheme Record Time were in certificated form, shall deliver certificates for the New Shares to the allottees in accordance with Clause [5(a)] of the Scheme. Where the Ordinary Shares at the Scheme Record Time were held in uncertificated form, BG Group will procure that CRESTCo is instructed to credit the appropriate stock account in CREST of the Ordinary Shareholder concerned with such shareholder's entitlement to such New Shares provided that BG Group may (if, for any reasons, it wishes to do so) determine that all or part of such consideration shall be settled in the manner referred to in the first sentence of this paragraph (i), and
  - (iv) pay such sums as may be payable in respect of fractional entitlements to New Shares pursuant to Clause 2(b) of this Scheme by the delivery to them of cheques or warrants in accordance with Clause [5(a)] (provided that in the case of cheques relating to the sale of any relevant New Shares pursuant to Clause [3(c)] such period shall be within ● business days

followings completion of such sale), or for Ordinary Shareholders whose shares are held through CREST, by procuring payment to their CREST account.

#### **4 [[Transfer] of Bonds]**

**[Include provisions for Bonds analagous to those for New Shares in 3(a), (c) and (d) above]**

#### **5 Certificates, [Bond Documents] and payments**

- (j) All deliveries of certificates, cheques or warrants required to be made pursuant to this Scheme shall be made by sending the same through the post in prepaid envelopes addressed to the persons respectively entitled thereto at their respective addresses appearing in the register of members of BG at the Scheme Record Time (or, in the case of joint holders, at the registered address as so appearing of that one of the joint holders whose name stands first in the register in respect of such joint holding) or in accordance with any special instructions regarding communications.
- (k) None of BG , BG Group or the nominee referred to in Clause [3(c)] shall be responsible for any loss or delay in transmission of certificates, cheques or warrants sent in accordance with the provisions of this Scheme which shall be sent at the risk of the persons entitled thereto.
- (l) All cheques and warrants shall be made payable to the holder or, in the case of joint holders, to the first-named holder of the Ordinary Shares concerned and the encashment of any such cheque or warrant or the payment to a CREST account in accordance with Clause 3(d)(ii) of this Scheme shall be a complete discharge to BG Group for the money represented thereby.
- (m) The preceding sub-clauses of this Clause 5 shall take effect subject to any prohibition or condition imposed by law.

#### **6 Certificates representing Ordinary Shares [Consider provisions relating to the Special Share, if required]**

With effect from and including the Effective Date, all certificates representing Ordinary Shares **[and the Special Share - to be considered]** shall cease to be valid in respect of such shares. In addition, with effect from and including the Effective Date, in respect of those shareholders holding their Ordinary Shares in uncertificated form, CRESTCo shall be instructed to cancel such shareholders' entitlement to the Ordinary Shares.

#### **7 Mandated Payments and other Instructions**

All mandates and other instructions to BG in force at the close of business on the Effective Date relating to Scheme Shares shall, unless and until revoked or

amended, be deemed as from the Effective Date to be valid and effective mandates and instructions to BG Group in relation to the corresponding New Shares allotted and issued pursuant to this Scheme.

**8 [Financial Assistance whitewash - any assistance required to be approved to be considered]**

**9 Operation of this Scheme**

This Scheme shall become effective as soon as an office copy of the Order under Section 425 of the Companies Act 1985 and confirming under Section 137 of the said Act the reduction of the capital of BG provided for by this Scheme shall have been duly delivered to the Registrar of Companies for registration and, in the case of the confirmation of the reduction of capital, registered by him.

**10** Unless this Scheme has become effective on or before ● or such later date, if any, as BG and BG Group may agree and the Court may allow, it shall never become effective.

**11** BG and BG Group may jointly consent on behalf of all persons concerned to any modification of or addition to this Scheme or to any condition which the Court may think fit to approve or impose.

Dated the ● day of ● 1999.

NOTICE OF COURT MEETING

IN THE HIGH COURT OF JUSTICE  
CHANCERY DIVISION  
COMPANIES COURT  
MR. REGISTRAR [●]

No. ● of 1999

IN THE MATTER OF BG PUBLIC LIMITED COMPANY

and

IN THE MATTER OF THE COMPANIES ACT 1985

NOTICE IS HEREBY GIVEN that by an Order dated ● 1999 made in the above matters, the Court has directed a meeting (the "Court Meeting") to be convened of the holders of the ordinary shares of 1 <sup>2</sup>/<sub>15</sub> each in the capital of BG Public Limited Company (the "Company") for the purpose of considering and, if thought fit, approving (with or without modification) a Scheme of Arrangement proposed to be made between the Company, the holders of its said ordinary shares [and the Special Shareholder (as defined in the said Scheme of Arrangement) - to be considered] and that such meeting will be held at ●, on ● 1999 at ● at which time and place all holders of ordinary shares are requested to attend.

A copy of the Scheme of Arrangement and a copy of the Explanatory Statement required to be furnished pursuant to Section 426 of the Companies Act 1985 are incorporated in the document of which this Notice forms part.

**Holders of ordinary shares may vote in person at the Court Meeting or they may appoint someone else, who need not be a member of the Company, as their proxy, to attend and vote in their place.**

**A form of proxy for use at the Court Meeting is enclosed with this notice.**

It is requested that forms of proxy be lodged with the Registrars of the Company, ● [address], no later than ● on ● 1999. But if forms are not so lodged they may be handed to the chairman at the Court Meeting.

In the case of joint holders, the vote of the senior who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the vote(s) of the other joint holder(s) and for this purpose seniority will be determined by the order in which the names appear in the register of members of the Company in respect of the joint holding.

Entitlement to attend and vote at the Court Meeting and the number of votes which may be cast at that meeting will be determined by reference to the register of members of the Company at ● on ● 1999.

If the Court Meeting is adjourned, entitlement to attend and vote will be determined by reference to the register of members of the Company 48 hours before the time of the adjourned meeting.

By the said Order the Court has appointed ● or, failing him, ● or failing him, ● to act as chairman of the Court Meeting and has directed the chairman to report the result thereof to the Court.

The said Scheme of Arrangement will be subject to the subsequent sanction of the Court.

DATED ● 1999

Linklaters  
One Silk Street  
London EC2Y 8HQ

Solicitors for the Company

## NOTICE

### GAS ACT 1986

#### Section 23(3)

### **Notice of proposal to modify the Standard and Special Conditions of the Public Gas Transporter Licence treated as granted under section 7 of the Gas Act 1986 to BG plc**

The Director General of Gas Supply, pursuant to 23(3) of the Gas Act 1986, hereby gives notice as follows –

1. In this notice –
  - “BG” means BG plc;
  - “the Director” means the Director General of Gas Supply;
  - “the Licence” means the Public Gas Transporter Licence treated as granted under section 7 of the Act to BG;
  - “the proposed modifications” means the proposed modifications to the Standard and Special Conditions of the Licence set out in Schedule 1;
  - “the Transco business” means the licensed gas transportation and liquified natural gas storage business carried on by BG under the name Transco.
2. The Director, pursuant to section 23(1)(a) of the Gas Act 1986, proposes to make the proposed modifications to the Licence.
3. The effects of the proposed modifications are –
  - (a) to delete the existing Special Condition 8A;
  - (b) to introduce into the Licence conditions
    - (i) prohibiting BG and its subsidiaries from conducting any business other than the Transco business, subject to exceptions for very small businesses and for businesses which it is unable to transfer out of BG,
    - (ii) requiring BG to use reasonable endeavours to cease conducting businesses other than the Transco business;
    - (iii) restricting BG from entering into or continuing or permitting to remain in effect (except in certain circumstances) cross default obligations;
    - (iv) requiring BG to act in a manner calculated to secure that it has adequate resources to carry on the Transco business;

- (v) requiring BG to maintain an investment grade credit rating, and
- (c) to make consequential modifications to the Licence, including new definitions, new information provisions and new restrictions on the disposal of assets;

these effects are more fully described in Chapter 4 of the paper that accompanies this notice.

4. The reason why the Director proposes to make the proposed modifications is that the opportunity has arisen, following a decision by BG to revise its corporate structure and to seek to move out of BG all businesses other than the Transco business, to introduce the proposed modifications and the Director is of the opinion that –
  - (a) it is in the interests of consumers in respect of prices and continuity of supply;
  - (b) it will facilitate the securing of effective competition in gas shipping and in gas supply; and
  - (c) BG will be better able to finance the carrying on of the Transco business,

if the proposed modifications are made; this reason is more fully set out and explained in Chapter 4 of the paper that accompanies this notice.

5. Representations or objections with respect to the proposed modifications may be made by 15 September 1999 and should be addressed to –

The Office of Gas and Electricity Markets  
Stockley House  
130 Wilton Road  
London  
SW1V 1LQ.

and marked for the attention of Justin Coombs.

The Official Seal of the Director General  
of Gas Supply hereunto affixed is  
authorised by

Authorised in that behalf by the  
Director General of Gas Supply

16 August 1999



**Schedule**  
**to the Notice of proposal to modify the Standard and Special**  
**Conditions of the Public Gas Transporter Licence treated as granted**  
**under section 7 of the Gas Act 1986 to BG plc**

1. In Special Condition 1, the words ““MD TransCo” means the officer referred to in Condition 8A1;” shall be deleted.
2. In Special Condition 1 at the places referred to below, there shall be inserted the following definitions:
  - (a) before the definition of “appointed day”

““the Act” means the Gas Act 1986;”
  - (b) after the definition of “authorisation”

““Cross-Default Obligation” means a term of any agreement or arrangement whereby the Licensee’s liability to –

    - (i) pay or repay any debt or other sum, or
    - (ii) to do any thing pursuant to a term of any agreement or arrangement to which the Licensee is a party

arises or is increased or accelerated or is capable of arising, increasing or of being accelerated by reason of a default (howsoever such default may be described or defined) by any person other than the Licensee, unless that liability

    - (a) can arise only as the result of a default by a subsidiary of the Licensee, and
    - (b) the Licensee holds a majority of the voting rights in that subsidiary and has the right to appoint or remove a majority of its board of directors, and
    - (c) that subsidiary carries on business only for a Permitted Purpose

provided that a liability on the part of the Licensee arising from a breach of covenant on the part of any successor in title to the Licensee in relation to any legal estate in real property shall not be regarded as a Cross-Default Obligation.”
  - (c) before the definition of “public gas supplier”

“Permitted Purpose” means the purposes of any or all of the following:

- (a) the Transportation and LNG Storage Business;
- (b) any business or activity within the limits of paragraph 6 of Special Condition 2;
- (c) any other business conducted or activity carried on by the Licensee or a company which was a subsidiary of the Licensee immediately before the Relevant Date and which, despite the Licensee’s reasonable endeavours to comply with Special Condition 2(1), it continues to carry on;
- (d) without prejudice to the generality of paragraphs (a) - (c), any payment or transaction lawfully made or undertaken by the Licensee for a purpose within subparagraphs (i) - (viii) of paragraph 7(b) of Amended Standard Condition 25. “

(d) after the definition of “related person”

““Relevant Date” means the date on which the Scheme of Arrangement becomes effective;

““Scheme of Arrangement” means the scheme under section 425 of the Companies Act 1985 relating to BG plc approved by the Director on [ • ];

“Subsidiary” shall bear the same meaning as that attributed to it in section 736 of the Companies Act 1985;

“Subsidiary Undertaking” shall bear the same meaning as that attributed to it in section 258 of the Companies Act 1985;”

(e) after the definition of “Supply of Transportation Services”

““the TransCo Business” has the same definition as in Amended Standard Condition 2(9);”

(f) after the definition of “Transportation System”

““Ultimate Holding Company” means each of –

- (i) a holding company of the Licensee which is not itself a subsidiary of another company;

- (ii) where a holding company of the Licensee which is not a subsidiary of another company has entered into an agreement affecting the exercise of voting rights in or the appointment or removal of directors of the Licensee or any company of which the Licensee is a subsidiary, every party to that agreement; and
- (iii) where the exercise of voting rights in or the appointment or removal of directors of a holding company of the Licensee which is not a subsidiary of another company is controlled by an agreement, every party to that agreement."

3. Insert after Special Condition 1 –

**"Special Condition 2: Restriction on activity and financial ring fencing**

1. Subject to paragraphs 3, 4 and 6, except with the written consent of the Director, the Licensee shall not, and shall procure that its subsidiary undertakings shall not, conduct any business or carry on any activity other than the TransCo Business.
2. The Licensee shall not acquire or retain, without the written consent of the Director, shares in any related person after the Relevant Date except:
  - (a) shares in any body corporate which is a subsidiary of the Licensee with the function only of facilitating the financing of activities of the Licensee or of its subsidiaries falling within sub-paragraph (a) or (b) of the definition of Permitted Purpose;
  - (b) shares acquired in a body corporate to which is transferred an activity that ceases, or is to cease, to be part of the TransCo Business;
  - (c) shares in a body corporate which conducts business only for a purpose within sub-paragraph (a) or (b) of the definition of Permitted Purpose;
  - (d) shares acquired in order to avoid dilution of a shareholding in a body corporate in which the Licensee holds shares in conformity with the Licence; or

- (e) shares in a body corporate which conducts business only for a Permitted Purpose within sub-paragraph (c) of the definition of Permitted Purpose where the acquisition of those shares is required to fulfil an obligation of the Licensee contained in an agreement or arrangement entered into before the Relevant Date or arises from the exercise of pre-emption rights of the Licensee arising from such an agreement or arrangement provided that such acquisition is made no later than 12 months from the Relevant Date .
- 3. The Licensee shall use reasonable endeavours to cease to conduct or carry on any such business or activity prohibited by paragraph 1 which it was conducting or carrying on at the Relevant Date and shall submit to the Director by 31 March in each calendar year a report setting out details of the endeavours it has made to cease to conduct or carry on such business or activity in the period of twelve months ending on the preceding 31 December, provided that for so long as the Licensee is making such reasonable endeavours, it may continue to conduct any such business or carry on any such activity.
- 4. Subject to paragraph 5, nothing in the Condition shall prevent:
  - (a) any related person of the Licensee from conducting any business or carrying on any activity;
  - (b) the Licensee from holding shares as, or performing the supervisory or management functions of, any investor in any body corporate in which it holds an interest consistently with the provisions of the Licence;
  - (c) the Licensee from performing the supervisory or management functions of a holding company in respect of any subsidiary in which it holds an interest consistently with the provisions of the Licence;
  - (d) the Licensee from carrying on any business or conducting any activity to which the Director has given his consent in writing.
- 5. From the Relevant Date, the Licensee without the written consent of the Director shall not:
  - (a) enter into an agreement or arrangement incorporating a Cross-Default Obligation, or

- (b) continue or permit to remain in effect any agreement or arrangement incorporating a Cross-Default Obligation subsisting on the Relevant Date save that any Cross-Default Obligation in existence at that date may remain in effect for so long as and provided that:
    - (i) the Cross-Default Obligation is solely referable to
      - (aa) an instrument relating to the provision of a loan or other financial facilities granted, or
      - (bb) an arrangement or agreement entered into prior to that date and the terms on which that loan or those facilities have been made available or of that agreement or arrangement as subsisting on that date are not materially varied to the detriment of the Licensee or otherwise made more onerous or where there is a material change in terms, such change is outside the Licensee's effective control;
    - (ii) the Licensee shall no later than three months from the Relevant Date procure that a related person of the Licensee shall indemnify the Licensee in respect of its liabilities and potential liabilities under the Cross-Default Obligation on terms approved in writing by the Director which terms shall include an obligation that the person granting the indemnity shall maintain, at all relevant times, an investment grade credit rating; and
    - (iii) the Licensee shall enforce the terms of the indemnity if so directed in writing by the Director.
  - (c) The provisions above shall not prevent the Licensee from giving any guarantee permitted by and in compliance with the requirements of paragraph 7 of Amended Standard Condition 25 of the Licence.
6. (a) Nothing in this Condition shall prevent the Licensee or any subsidiary of the Licensee conducting any business or carrying on any activity other than businesses or activities falling within sub-paragraph (a) or (c) of the definition of Permitted Purpose (in this paragraph "the de-minimis

business”) so long as the limitations in this paragraph are complied with, namely –

- (i) the aggregate turnover of all the de-minimis business does not in any period of twelve months commencing on 1 January in the year 2000 and in any subsequent year exceed 2.5% of the turnover of the Transportation and LNG Storage Business (excluding the turnover on transactions which the Transportation and LNG Storage Business make with each other) as shown by its most recent accounting statement produced under paragraph 2(b) of Amended Standard Condition 2; and
  - (ii) the aggregate amount (determined in accordance with sub-paragraph (c) below) of all investments made by the Licensee in all its de-minimis business does not at any time after 1 January 2000 exceed 2.5% of the sum of share capital in issue, share premium and consolidated reserves of the Licensee as shown by its most recent financial statement then available; and
  - (iii) the business is conducted employing persons or assets first employed or acquired for the purposes of the TransCo Business.
- (b) For the purpose of sub-paragraph (a) of this paragraph, “investment” means any form of financial support or assistance given by or on behalf of the Licensee for the de-minimis business whether on a temporary or permanent basis including (without limiting the generality of the foregoing) any commitment to provide any such support or assistance in the future.
- (c) At any relevant time, the amount of an investment shall be the sum of –
- (i) the value at which such investment was included in the audited balance sheet of the Licensee as at the latest accounting reference date to have occurred prior to 1 January 2000 (or, where the investment was not so included, zero),

- (ii) the aggregate gross amount of all expenditure (whether of a capital or revenue nature) howsoever incurred by the Licensee in respect of such investment in all completed accounting reference periods since such accounting reference date, and
  - (iii) all commitments and liabilities (whether actual or contingent, contingent liabilities being estimated and disclosable in the manner provided in Financial Reporting Standard 12 as issued by the Accounting Standards Board (as the same may be amended or replaced to be consistent with prevailing UK GAAP)) of the Licensee relating to such investment outstanding at the end of the most recently completed accounting reference period.
- (d) Any expenditure (as used in 6(c)(ii) above) and commitments and liabilities (as used in 6(c)(iii) above) relating to businesses or activities will cease to be included in the sums referred to in sub-paragraph 6(c) above from the accounting period following the accounting period in which the business or activity is transferred out of the Licensee provided that where the consideration received by the Licensee for the transfer of the business or activity is less than the aggregate of:
  - (i) any expenditure in respect of that business or activity included in the sums referred to in sub-paragraph 6(c)(ii) above; and
  - (ii) any commitments and liabilities in relation to the relevant business or activity referred to in sub-paragraph 6(c)(iii) above retained by the Licenseethen only the amount of the consideration received by the Licensee will cease to be included for this purpose.
- (e) Any business or activity so designated by the Director shall not be considered a de-minimis business for the purpose of the limitations in this paragraph 6.

7. If the Director, having regard, in particular, to any representations made to him by the Licensee and other persons as to the extent to which there is competition in relation to the storage of gas in LNG

Storage Facilities and his view on that question, considers it appropriate that this Special Condition should be construed as if the definition of “the TransCo Business” made no reference to the “LNG Storage Business” then for the purpose of this Special Condition, with effect from the date specified in a notice published by the Director for that purpose, the definition of “the TransCo Business” shall be so construed and shall be treated as modified accordingly.

### **Special Condition 3: Sufficiency of resources**

1. The Licensee shall at all times act in a manner calculated to secure that it has sufficient management resources, financial resources and financial facilities to enable it to carry on the Transportation and LNG Storage Business and to comply with its obligations under the Act and its Licence.
2. In each year commencing from 1 January 2000, the Licensee shall submit on 31 March a certificate as to the adequacy (or otherwise) of its management resources and financial resources and facilities for the period of twelve months commencing on the date of the certificate. Each certificate shall be in one of the following terms:
  - (a) “After making enquiries, the directors of the Licensee have a reasonable expectation that the Licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, sufficient management resources and financial resources and financial facilities to enable the Licensee to carry on the activities authorised by the Licence in accordance with its obligations under the Act and under the Licence for the period of 12 months referred to in this certificate.”
  - (b) “After making enquiries, the directors of the Licensee have a reasonable expectation, subject to the factors set out below, that the Licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, sufficient management resources and financial resources and financial facilities to enable the Licensee to carry on the activities authorised by the Licence in accordance with its obligations under the Act



and under the Licence for the period of 12 months referred to in this certificate. However, they would like to draw attention to the following factors which may cast doubt on the ability of the Licensee to carry on the activities authorised by the Licence as aforesaid."

- (c) "In the opinion of the directors of the Licensee, the Licensee will not have available to it sufficient management resources and financial resources and financial facilities to enable the Licensee to carry on the activities authorised by the Licence in accordance with its obligations under the Act and under the Licence for the period of 12 months referred to in this certificate."
3. The Licensee shall submit to the Director with that certificate a statement of the main factors which the directors of the Licensee have taken into account in giving that certificate.
  4. The Licensee shall -
    - (a) notify the Director in writing immediately if its directors become aware of any circumstance that causes them to no longer have the reasonable expectation expressed in the most recent certificate; and
    - (b) subject to compliance with the listing rules (within the meaning of Part IV of the Financial Services Act 1986) of the Stock Exchange, publish its notification to the Director in such form and manner as the Director may direct.
  5. Save in so far as they relate to management resources, the Licensee shall use its best endeavours to obtain and submit to the Director with each certificate provided for in paragraph 2 a report prepared by its Auditor and addressed to the Director stating whether or not the Auditor is aware of any inconsistencies between, on the one hand, that certificate and the statement submitted with it and, on the other hand, any information which he obtained during his audit work.
  6. The Licensee shall procure from each company or other person which is at any time an Ultimate Holding Company of the Licensee a legally enforceable undertaking in favour of the Licensee in the form specified by the Director that that ultimate holding company ("the Covenantor") will refrain from any action, and will procure

that every subsidiary of the Covenantor (other than the Licensee and its subsidiaries) will refrain from any action, which would then be likely to cause the Licensee to breach any of its obligations under the Act or the Licence. This undertaking shall be obtained within 7 days of the company or other person in question becoming an Ultimate Holding Company of the Licensee and shall remain in force for so long as the Licensee remains the holder of the Licence and the Covenantor remains the Ultimate Holding Company of the Licensee.

7. The Licensee shall:
  - (a) deliver to the Director evidence (including a copy of such undertaking) that the Licensee has complied with the obligation to procure an undertaking pursuant to paragraph 6; and
  - (b) shall inform the Director immediately in writing if the directors of the Licensee become aware that the undertaking has ceased to be legally enforceable or that its terms have been breached.
  
8. The directors of the Licensee shall not declare or recommend a dividend, nor shall the Licensee make any other form of distribution within the meaning of section 263 of the Companies Act 1985, unless prior to the declaration, recommendation or making of the distribution (as the case may be) the Licensee shall have issued to the Director a certificate complying with the following requirements of this paragraph.
  - (a) The certificate shall be in the following form:

“After making enquiries, the directors of the Licensee are satisfied:

    - (i) that the Licensee is in compliance in all material respects with all obligations imposed on it by Special Conditions 2, 3 and 4 and by paragraphs (7) to (8) of Amended Standard Condition 16 and (7) of Amended Standard Condition 25 of the Licence; and
    - (ii) that the making of a distribution of [*amount*] on [*date*] will not, either alone or when taken together with other circumstances reasonably foreseeable at the date of this certificate, cause the Licensee to be in

breach to a material extent of any of the obligations imposed on it by Special Conditions 2, 3 and 4 and by paragraph (7) of Amended Standard Condition 25 of the Licence in the future.”

- (b) The certificate shall be signed by a director of the Licensee and approved by a resolution of the board of directors of the Licensee passed not more than 14 days before the earliest of the dates on which the declaration, recommendation or payment will be made.
  - (c) Where the certificate has been issued in respect of the declaration or recommendation of a dividend, the Licensee shall be under no obligation to issue a further certificate prior to payment of that dividend.
9. To the extent that the Licensee procures any of the matters referred to in paragraph 1 from any Ultimate Holding Company or any subsidiary undertaking of such Ultimate Holding Company (other than subsidiaries of the Licensee) the Licensee shall ensure that the arrangements for procuring those matters do not involve an unjustified cross subsidy from the TransCo Business to any Ultimate Holding Company or to any subsidiary undertaking of such Ultimate Holding Company (other than the subsidiaries of the Licensee).
10. If the Director, having regard, in particular, to any representations made to him by the Licensee and other persons as to the extent to which there is competition in relation to the storage of gas in LNG Storage Facilities and his view on that question, considers it appropriate that this Special Condition should be construed as if the definition of “the TransCo Business” made no reference to the “LNG Storage Business” then for the purpose of this Special Condition, with effect from the date specified in a notice published by the Director for that purpose, the definition of “the TransCo Business” shall be so construed and shall be treated as modified accordingly.

**Special Condition 4: Investment grade credit rating as issuer of corporate debt**

1. The Licensee shall use all reasonable endeavours to ensure that the Licensee as issuer of any corporate debt maintains an investment grade credit rating.
2. In this condition:  
“corporate debt” means any unsecured and unsubordinated borrowing of money having an initial maturity of five years or more; and  
“investment grade credit rating” means –
  - (a) a rating of not less than BBB- by Standard & Poor’s Ratings Group or any of its subsidiaries or not less than Baa3 by Moody’s Investors Service, Inc. or any of its subsidiaries or such higher rating as shall be specified by either of them from time to time as the lowest investment grade credit rating, or
  - (b) an equivalent rating from any other reputable credit rating agency which, in the opinion of the Director, notified in writing to the Licensee, has comparable standing in the UK and the USA.”
4. Delete Special Condition 8A.
5. In Standard Condition 2, as amended in its application to BG –
  - (a) insert “and” at the end of sub-paragraph 1(c);
  - (b) delete “and;” at the end of sub-paragraph (1)(d);
  - (c) delete sub-paragraph (1)(e);
  - (d) in sub-paragraph (2)(b)(i)(cc) delete “except in respect of any Common Service Business;”;
  - (e) Delete sub-paragraph (3)(a) and insert in its place  
“(3)(a) Each of the accounting statements prepared under paragraph (2)(b)(i) shall show separately, but in aggregate only, the total amounts of any revenues, costs, assets or liabilities which have been charged:

- (i) from any Ultimate Holding Company of the licensee, together with any subsidiaries of such Ultimate Holding Company (other than the Licensee or its subsidiaries), in relation to the provision of goods or services to the Licensee;
- (ii) from the Licensee in relation to the provision of goods or services to any Ultimate Holding Company of the Licensee together with any subsidiaries of such Ultimate Holding Company (other than the Licensee or its subsidiaries);
- (iii) or determined by apportionment to or from any other business (whether or not a Separate Business) of the Licensee

provided that the obligations in (i), (ii) and (iii) above shall apply only to goods and services received or supplied for the purpose of the Transportation and LNG Storage Business

- (b) The Licensee shall furnish the Director with a separate statement setting out an analysis, in appropriate detail, of the aggregate figures referred to in sub-paragraph (a) above, together with a description of the basis of the charge or apportionment. “;
- (f) Redesignate sub-paragraphs (3)(b), (3)(c), and (3)(d) as (3)(c), (3)(d) and (3)(e) respectively;
- (g) In paragraph (7) delete the words “any accounting statement for a Common Service Business or”;
- (h) Delete paragraph (8) and insert in its place
  - “(8) Paragraph (7) shall not require publication of –
    - (a) any accounting statements for the LNG Storage Business where publication would or might seriously and prejudicially affect the interests of the Licensee, any Ultimate Holding Company of the Licensee or any subsidiary of any Ultimate Holding Company and for this purpose the Licensee shall (except in so far as the Director consents to the Licensee not doing so) refer for determination by the Director any question as to whether any such publication would or might so affect the interests of the Licensee; or

- (b) any of the statements referred to in sub-paragraph 3(b) of this Condition. “;
  - (i) in paragraph (9)
    - (i) delete the definition of “Common Service Business”, and
    - (ii) amend the definition of “the TransCo Business” to read “the TransCo Business” means business carried on by the Licensee within the definition of “Permitted Purpose;”
    - (iii) in the definition of “Separate Business” delete “(e)” and insert “(d)”.
6. In Standard Condition 16, as amended in its application to BG, insert after paragraph (6) the following –
- “(7) The Licensee shall procure from each and every Ultimate Holding Company of the Licensee a legally enforceable undertaking in favour of the Licensee in such form as may be specified by the Director requiring that holding company to give to the Licensee and to procure that each subsidiary of that holding company (other than the Licensee and its subsidiaries) will give to the Licensee, all such information as may be necessary to enable the Licensee to meet its obligations under the Act and under the Licence to produce documents and furnish information to the Director.
  - (8) The Licensee shall comply with any direction from the Director to enforce any of the undertakings procured pursuant to paragraph (7).
  - (9) The Licensee shall deliver to the Director evidence that the Licensee has complied with the obligation to procure all such undertakings as are required pursuant to paragraph (7), including copies of such undertakings.
  - (10) The Licensee shall not, save with the Director’s written consent, enter (directly or indirectly) into any agreement or arrangement with any Ultimate Holding Company of the Licensee or any subsidiaries of such Ultimate Holding Company (other than the subsidiaries of the Licensee) at a time when (a) an undertaking required pursuant to paragraph (7) is not in place or (b) there is an unremedied breach of such undertaking.
  - (11) In this condition “information” shall include any documents, accounts, estimates, returns, forecasts or reports (whether or not

prepared specifically at the request of the Director) of any description specified by the Director.”

7. In Standard Condition 25, as amended in its application to BG, insert after paragraph (6) the following –

“(7) Except where the Director has consented prior to the Relevant Date, without prejudice to paragraphs (1) to (6) above, save with the written consent of the Director after full disclosure of all material facts, the Licensee shall not after the Relevant Date

(a) create any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or guarantee any liability or obligation of another person unless it is on an arm’s length basis, on normal commercial terms and

(i) for purposes within sub-paragraphs (a), (b) or (d) of the definition of Permitted Purpose in Special Condition 1; or

(ii) for purposes within sub-paragraph (c) of that definition and it is required to fulfil an obligation of the Licensee contained in an agreement or arrangement entered into before the Relevant Date or arising from the exercise of pre-emption rights of the Licensee arising from such an agreement or arrangement provided that such creation or undertaking is made no later than 12 months from the Relevant Date;

(b) transfer, lease, licence or lend any sum or sums, asset, right or benefit to any related person of the Licensee otherwise than by way of:

(i) a dividend or other distribution out of distributable reserves;

(ii) repayment of capital;

(iii) payment properly due for any goods, services or assets provided on an arm’s length basis and on normal commercial terms;

- (iv) transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis and on normal commercial terms;
- (v) repayment of any loan or payment of any interest on a loan not prohibited by sub-paragraph (a);
- (vi) payments for group corporation tax relief or for the surrender of Advance Corporation Tax on a basis not exceeding the value of the benefit received;
- (vii) a transfer for the purpose of satisfying the obligation to cease to carry on non regulated business; or
- (viii) an acquisition of shares in conformity with the restriction on the acquisition of shares set out in the Licence, made on an arm's length basis and normal commercial terms."



## **Annex 3: Process for moving businesses out of BG plc into separate subsidiaries**

### **Introduction**

This Annex outlines a standardised process for decisions on the initial transfers and further unbundling of BG plc's businesses. This process will consist of:

- a **proposal** from BG plc to move a given business, together with an opinion from BG plc on whether the business qualifies as "ancillary" as explained in chapter 5 of his document. Ofgem will then decide whether to accept BG plc's view as to whether the business is ancillary
- Ofgem will then send BG plc a **questionnaire** in order to elicit necessary information. Ofgem will also ask BG to provide confirmation that all relevant contingent liabilities are either to be moved, or else to be duly counter-indemnified;
- as part of its response, BG plc would provide a **reconciliation** between the assets to be moved out, the residual value of Transco and the regulatory accounts; and
- in the case of each "ancillary" business, Ofgem will expect to conduct an individual **consultation** process.

This note briefly summarises each element of this process in turn.

### **Proposal**

BG plc should send a proposal to Ofgem to initiate this process. This proposal should contain:

- a description of the business to be moved, including its activities, the book value of its assets and the number of its employees;
- BG plc's view as to whether the business is ancillary and its reasons, if any, for its view; and

- a view, where BG plc considers that the business or activity is ancillary, on whether or not the market in which the business operates, or the activity is undertaken, is contestable.

### **Questionnaire and Confirmation**

As the next stage of the process, Ofgem should send a questionnaire to BG plc, asking for relevant information. This will allow Ofgem to satisfy itself that the business is or is not ancillary. If the business is ancillary, a more detailed discussion between Ofgem and Transco on the implications of the transaction will be necessary. In either case, Ofgem will wish to satisfy itself that:

- any assets being moved are appropriate to the business or activity being moved; and
- all identified contingent liabilities and guarantees related to the business are to be moved out where possible, or counter indemnified by BG Energy Holdings where this is impractical (or inappropriate on a transitional basis).

BG plc should confirm that this is the case.

### **Reconciliation**

BG plc should provide a reconciliation between Transco's regulatory accounts, the value of any assets moved out, and the value of BG Transco plc, together with an explanation of any differences. In relation to the initial transfers, BG plc have proposed to provide a table in five columns:

- Column A: the balance sheet of BG plc;
- Column B: the balance sheets of each of the business to be transferred;
- Column C: the balance sheet of BG Transco Holdings;
- Column D: any adjustments required to reconcile Column C and Column E; and
- Column E: the balance sheet from the regulatory accounts.

For the balance sheets to reconcile:

- Column A – Column B = Column C; and
- Column C + Column D = Column E.

### **Consultation**

Where the business has been identified as an ancillary business in BG plc's response to the questionnaire above, Ofgem may want to undertake a consultation, and possibly to propose licence modifications.

## **Annex 4: Description of principal businesses to be transferred to BG Energy Holdings as part of the restructuring (provided by BG plc)**

### **BG International**

With effect from 1 May 1999, BG plc merged its exploration and production and international downstream businesses to form BG International. BG International is principally engaged in gas and oil exploration and production and the integrated development and supply of gas markets. BG International has a portfolio of investments in 20 countries which includes exploration and development concessions, gas and oil producing assets and gas transmission and distribution, gas fired power generation and liquefied natural gas businesses.

### **BG Property**

BG Property manages BG plc's extensive property portfolio (excluding Transco operational land). The portfolio consists of land and buildings occupied for business needs, properties leased to third parties and surplus properties and sites. BG owns a large number of former gasworks and associated sites which are contaminated. It continues to be actively involved in reclamation and regeneration of these sites.

### **BG Technology**

BG Technology delivers an extensive package of leading edge scientific and engineering consultancy, contract research and other services to the BG group, as well as commercially to the international private and public sectors. BG Technology's test site in the UK offers the capability for studies of major hazards, industrial product performance assessment and environmental studies for the oil and gas industry, process industry, components manufacturers and regulatory authorities.

### **The Leasing Group**

The Leasing Group plc undertakes a variety of leasing activities both within the BG group and for external customers; the latter account for a third of its total assets of over £200 million. The Leasing Group brings together BG plc's considerable experience in

the specification, procurement and operation of very large mixed vehicle fleets, with over 22,000 cars and commercial vehicles under its control. The Leasing Group is developing the market for natural gas as a very clean alternative vehicle fuel, particularly for heavy goods vehicles.

### **BG Intellectual Property**

BG Intellectual Property Limited is the corporate vehicle into which all the registered and registerable intellectual property owned by BG plc will be hived down, where legally possible. BG plc currently has over 2,000 patents and applications for patents spread between 64 countries and over 2,000 registered trademarks and applications for trademarks in 56 countries.

### **BG Insurance**

BG's Insurance Department evaluates risk, collates underwriting and claims information and designs insurance arrangements. It insures the worldwide assets and liabilities of the Group through its own insurance subsidiary company, BG Insurance Company Limited, which is located in the Isle of Man. The subsidiary was set up in 1987 and is independently managed by an external insurance management company.

## **Annex 5: Letter from Ofgem to BG plc of 17 June 1999**

COMMERCIAL IN CONFIDENCE

David Varney Esq.,  
BG plc  
100 Thames Valley Park Drive  
Reading  
Berks  
RG6 1PT

17 June 1999

Dear David,

### **Project Schooner**

I am writing to set out our further views on Project Schooner (the 'Project'). Since I last wrote to you, we have had a number of meetings with your team to define the Project and to explore the issues involved. I am most grateful on behalf of my team for the efforts you have made to have meetings and provide us with relevant information.

### **Background**

We understand that you intend to make a public announcement on or around 18 June 1999 about the Project, which will pave the way for a major corporate restructuring. The restructuring is to be initiated by one or more Schemes of Arrangement to be approved by the Court ('the Court of Schemes'), which will enable a series of transactions ('the Transactions') by which it is intended over time that the core transportation business ('Transco') will become a 'ring-fenced' member of a wider group. The Transactions envisage businesses, shares in subsidiaries and other assets and liabilities being transferred out of BG plc into a new grouping of businesses under a new group holding company. The corporate restructuring is being accompanied by a financial restructuring which may affect the level of debt in Transco and involves the issue of bonds.

### **The role of OFGAS**

OFGAS has a number of roles to play in Project Schooner and the Transactions. Any Court of Scheme to which BG plc is party will require further approval. We will need to consider how the Project as a whole is consistent with the relevant duties of the Director General of Gas Supply ('the Director') and BG plc; and, as the Transactions progress, how each should be approved. You have informed us that you envisage the Transactions including the transfer out of BG plc of the following non-Transco business activities: the international businesses, property, storage (with LNG being the subject of imminent review), leasing, technology, intellectual property, insurance, and corporate centre. In addition you are looking to transfer Pipeline Maintenance Centre, Engineering Services Unit and Technical Training to Technology. In due course we understand that as part of the further unbundling process, you are likely to seek to

transfer connections, meter ownership and other meter-related businesses out of Transco.

### **Broad approach**

We are broadly supportive of the Project. In particular we support the principle of ring-fencing the Transco business, which should aid regulatory clarity and accountability, and we envisage modifications to BG plc's PGT licence to reinforce this principle. Insofar as the financial restructuring is designed to improve the efficiency of the financial management of Transco, this is also welcome.

### **Public consultation**

The Project is of such importance that we will wish to consult publicly about it. This is in any case a statutory requirement in respect of the modifications to BG plc's PGT licence which the Project entails. We intend to prepare documents for the consultation process immediately after your announcement, although you will appreciate that we will require further information relating to the Project for this purpose.

### **Need for subsequent approvals**

It needs to be clear that our support does not amount at this stage to approval of any Scheme of Arrangement, the Transactions or the financial restructuring. We have not seen the detailed terms of any of these and each will be considered on its merits as described below. Subject to this, and subject to the outcome of the consultation process and acceptable documentation (including the detailed documentation relating to any Court Scheme and Transaction and your prior agreement to the proposed licence modifications being implemented upon a Court Scheme to which BG plc is a party becoming effective), currently I am aware of no reason why the Director should not consent to a Court Scheme involving BG plc and to the Transactions at the appropriate times.

### **Financial issues**

As far as the financial structuring is concerned, we draw an important distinction between satisfying ourselves now in respect of the Director's duties and making a longer-term judgement about the efficiency of Transco's financing. In terms of fulfilling the Director's duties at this stage, the proposed 'ring-fencing' licence modifications that we have put forward to you contain various necessary safeguards. We make no other comment on the proposed indebtedness in the financing of Transco or its terms, nor any longer term judgement about its efficiency. It will be appropriate to consider the efficiency of the financial management of Transco as part of its next price control review.

We do not believe that it is appropriate for the Project, or any Court Scheme, or the Transactions, to cause any change to the present timetable for the Transco price control review. By the same token, neither this letter nor any subsequent approval of a Scheme or a Transaction should be considered to fetter the discretion of the Director in any aspect of the price control review; for the avoidance of doubt this includes our view on the efficiency of the financial management of Transco and the appropriate value of its regulatory asset base.

The level of indebtedness in other group companies (such as Transco Holdings) is not our direct concern. We expect customers of Transco not to be affected by corporate factors outside the licenced activities; in particular they should not be expected to bear any costs of any requirements of other members of your group, where these arise outside the scope of the PGT licenced activities.

You have told us that an inter-company account owed by Transco Holdings to Transco will arise as a result of transferring businesses out of BG plc and that it will increase as subsequent businesses are removed. We understand that your proposal is that, if such an account proves necessary, it would be perpetual and non-interest bearing. It is our view that such a perpetual, non-interest bearing account should not be part of Transco's regulatory asset base and we will need to examine with you the terms of that account.

It will be a pre-condition of our consent to the Project and the Transactions that you recognise and explicitly acknowledge the distinctions being drawn in this section and the reserving of the Director's position in terms of the conduct of the next price control review by signing the declaration at the end of this letter.

### **Process for approvals**

We envisage that you will be bringing forward detailed documentation for our approval in respect of any Court Schemes and the Transactions. Any Court Scheme that requires our approval and each Transaction will be considered in the light of its impact on:

- Transco. We have already indicated that we will require modifications to the PGT licence and we have provided you with a draft of our proposals which we understand you will be reviewing.

You will note that it is the intention of the modifications that Transco retains only those contingent liabilities which are related to its PGT business whether current or historic and which are not related to assets forming part of the businesses which are the subject of the Transactions. Where it is impractical (or inappropriate on a transitional basis) to transfer these contingent liabilities out of Transco, such liabilities may remain in Transco, but the group will need to indemnify Transco against any outgoings related to such contingent liabilities. We will need to consider the adequacy of the financial status of the group member providing these indemnities and of the indemnity terms.

For all Transactions, subject to an overall test of materiality to be determined by the Director, we will require a schedule of the resources, assets and liabilities (including contingent liabilities) relevant to the business being transferred, as well as updated projections for Transco following each Transaction, together with all other documentation relating to the terms of the transfer.

We will wish to consider whether Transco can fulfil its obligation (including its statutory obligations and the modified terms of its PGT licence) if the relevant Scheme or Transaction is effected. The ring-fenced PGT licence conditions will survive each Transaction and in respect of each Transaction we will require some form of certification from Transco that the conditions will continue to be met.



- The transferred business, in the case of businesses which are currently regulated by the PGT licence and/or are deemed to be 'ancillary' (within the meaning of Section 36A of the Gas Act 1986).

We will need to consider the terms of each transfer. We shall be concerned to ensure that the transfer of an ancillary business does not confer on the transferred business any undue competitive advantage. We may need to take advice and consult on individual Transactions.

We believe that these principles are consistent with the general approach being taken in the discussions of individual Transactions which are already in progress.

We recognise that this letter is a disclosable document in relation to the transaction and any associated public documentation.

Yours sincerely

**Richard Morse**  
**Deputy Director General**

On behalf of BG plc I acknowledge receipt of this letter and I acknowledge the distinction between the Director's support for the Project and subsequent approval of a Scheme or a Transaction, on the one hand, and any position the Director may take with respect to any aspect of the next price control review, on the other hand, as drawn in the section headed Financial Issues. This acknowledgement is given, similarly, without prejudice to any position BG plc may take with respect to any aspect of the next price control review (other than questioning the validity of this acknowledgement).

For and on behalf of BG plc