

December 1999

BG plc corporate restructuring

Decision document



## 1 INTRODUCTION

1.1 On 18 June 1999 BG plc announced its intention to implement a corporate restructuring. On 16 August 1999, Ofgem issued a consultation document (BG plc Corporate Restructuring – A Consultation Document and Licence Modifications), seeking views on whether:

- the Director General of Gas Supply ('the Director') should approve the Scheme of Arrangement necessary for the implementation of that transaction;
- the proposed amendments to BG plc's Public Gas Transporter (PGT) licence, which Ofgem announced in accordance with Section 23 of the Gas Act, would be adequate for the purposes for which they were designed; and
- the Director should consent to the moving of certain non-ancillary businesses from BG plc into new subsidiaries.

1.2 This document explains Ofgem's decisions on each of these points. Following this Introduction, this document consists of the following sections:

- Ofgem's decision;
- Background;
- Responses to the consultation; and
- Conclusion.

1.3 A summary of the responses is contained in Annex 1. Terms in this document are as defined in the August document.

## 2 OFGEM'S DECISION

2.1 Ofgem has decided to:

- approve the Scheme of Arrangement for BG plc's restructuring;
- enact the amendments to BG plc's PGT licence as published in the consultation document, subject to some minor amendments; and
- consent to the transfer of the non-ancillary businesses listed below from BG plc into BG Energy Holdings.

2.2 The non-ancillary businesses which will be moved as a part of this transaction are:

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

2.3 The notice enacting the amendments to BG's PGT licence is published in Annex 2.

2.4 A summary of the restructuring is contained in Ofgem's consultation document.

### 3 RESPONSES TO THE CONSULTATION

3.1 Ofgem received responses from 13 companies and organisations. Nine of these included substantive comments, of which one response was confidential. A summary of the points raised in the eight public responses is set out in Annex 1. This section summarises the salient points of the responses received and Ofgem's conclusions on each point.

3.2 The consultation document invited views in a number of specific areas:

#### **Scheme of Arrangement**

- (i) whether Ofgem should approve the Scheme of Arrangement;

#### **Licence Amendments**

- (ii) whether the proposed Special Condition 2 would 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;

- (iii) whether the proposed Special Condition 3 would 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 on 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;

- (iv) whether the requirement on BG Transco plc to maintain an issuer investment-grade credit rating was appropriate and would be effective at reinforcing the requirements of Special Condition 3;

- (v) whether the proposed Amended Standard Condition 16 will ensure that Ofgem had access to the information necessary to fulfil the Director's duties;

- (vi) whether the licence, as amended, would constitute a sufficient financial and physical ringfence for the regulated business;

- (vii) whether Special Condition 8A would be redundant given then provisions in the ringfence;

- (viii) whether any additional conditions should be added to Transco's licence;

### **Individual transactions**

- (ix) whether the distinction between ancillary and non-ancillary businesses described in the consultation document was appropriate;
- (x) whether the businesses listed in the consultation document were non-ancillary;
- (xi) whether Ofgem had correctly identified the potential regulatory issues arising from the movement of ancillary and non-ancillary businesses; and
- (xii) whether Ofgem's proposed procedures for the movement of these businesses would be appropriate and effective.

### **Scheme of Arrangement**

#### *Summary of responses*

3.3 Two respondents commented on the Scheme of Arrangement. Both considered that Ofgem should approve the Scheme as contained in Annex 1 of the consultation document.

#### *Ofgem's response*

3.4 Ofgem has approved the Scheme of Arrangement.

### **Special Condition 2**

#### *Summary of responses*

3.5 Respondents raised concerns relating two aspects of Special Condition 2:

- de minimis businesses: the extent to which Transco should be allowed to conduct businesses not included under the definition of "Permitted Purpose", and how this revenue should be treated under the price control; and
- cross-default obligations: whether Transco should generally be required to dispose of obligations and guarantees no longer relevant to its business and, where this was impracticable, obtain a counter-indemnity.

3.6 On the first point, two respondents felt that the limit on de minimis businesses (at 2.5 per cent of turnover or asset value) was too low: one respondent questioned whether any such limit was appropriate, while another felt that the limit of 5 per cent in the electricity ringfence would be more appropriate. One respondent considered that Transco should receive no additional revenue from such services, if assets paid for by Transco's customers were used to provide them.

3.7 Three respondents commented on the treatment of cross-default obligations in the proposed licence modifications. One respondent considered that the proposed procedures for counter-indemnification were too stringent, commenting that the provisions in the proposed licence amendments were tougher than those in the

electricity ringfence, while another supported Ofgem's proposals. A third respondent proposed that Ofgem secure the right to approve any guarantees given by BG Group plc on behalf of BG Energy Holdings.

### *Ofgem's response*

- 3.8 On the first point, Ofgem considers that the provision of services not directly related to Transco's core activities using transportation assets can benefit consumers and reduce Transco's costs. Ofgem recognises that Transco should be given an incentive to provide such services. However, Ofgem considers that such services should constitute only a small part of Transco's revenue, to preserve regulatory transparency. Accordingly, Ofgem does not believe that the de minimis limit contained in the consultation document should be altered. Ofgem intends to consult separately on the appropriate de minimis level to apply in electricity licences if the Utilities Bill is enacted.
- 3.9 Ofgem believes that the treatment of cross-default obligations in the proposed licence conditions is correct. BG plc itself proposed the counter-indemnification provisions, in order to address those guarantees which were not related to Transco's Permitted Purposes but which it was not feasible to transfer. A counter-indemnification of such a guarantee will ensure that Transco's financial stability is not jeopardised by such guarantees. Ofgem considers, however, that, since both BG Group plc and BG Energy Holdings fall outside the regulatory ringfence, guarantees given by BG Group on behalf of BG Energy Holdings are not a matter which will affect Ofgem's duties.

### **Special Condition 3**

#### *Summary of responses*

- 3.10 Respondents raised two issues on the proposed Special Condition 3:
- prohibition of dividends: whether the restriction of dividend payments if Transco is in breach of Amended Standard Condition 16 was appropriate; and
  - enforcement of Transco's duties: whether the general provisions requiring Transco to fulfil its Gas Act and Licence obligations were sufficient.
- 3.11 Three respondents (BG plc and two other licensed energy companies) commented on the restriction of dividend payments. All considered that the prohibition was unnecessary, and two respondents considered that it was disproportionate. BG plc commented that the prohibition was inconsistent with the electricity ringfence provisions, that the Director had not given sufficient reasons for his concern, and that Section 38 of the Gas Act allows the Director to take enforcement action if other members of the BG group do not provide him with information. Additionally, BG plc commented that, if the provision was included in the Licence, a Code of Practice on the exercise of the Director's powers would assist it with its compliance with the new provisions.
- 3.12 Two respondents commented on the general provisions requiring Transco to fulfil its Gas Act and Licence duties. One respondent supported the requirement on

Transco to obtain an undertaking from its ultimate holding company not to cause Transco to breach its Licence or the Gas Act, and not to allow its subsidiaries to cause Transco to breach its Licence or the Gas Act. Another respondent commented that the requirements on Transco to secure sufficient management and financial resources were unnecessary, since Transco should be regulated by the results it achieved, rather than the resources it required.

#### *Ofgem's response*

- 3.13 Ofgem recognises that the new prohibition on dividends is more stringent than existing conditions in PES licences, but it considers that the provision is a valuable addition to its powers to secure information necessary for the fulfilment of its duties. However, Ofgem recognises BG plc's concerns regarding the operation of this provision and intends to make a written statement regarding the manner in which these provisions would be used. Ofgem intends to consult separately on whether a similar provision should exist in electricity distribution licences if the Utilities Bill is enacted.
- 3.14 Ofgem considers that the provision which requires Transco to secure sufficient management and financial resources to fulfil its Gas Act and Licence duties is necessary. By the time any deficiency in Transco's management or financial resources have become apparent, considerable damage may already have been done, and any enforcement action may be too late. Requiring an advance certification, on the other hand, should prevent such a situation from occurring.

#### **Special Condition 4**

##### *Summary of responses*

- 3.15 Respondents raised two main issues on the requirement on Transco to maintain an investment grade credit rating:
- whether such a requirement was appropriate; and
  - whether it was appropriate for an "issuer" investment grade rating to be maintained rather than that each debt issue by the licensee maintained an investment grade rating.
- 3.16 Two respondents commented on the first issue: one considered that such a requirement was appropriate, while the other argued that it was unduly restrictive.
- 3.17 One respondent commented that requiring an "issuer" rating to be a certain grade appeared to be more restrictive than requiring that each debt issue maintains that rating, and that such "creeping" regulation could increase regulatory uncertainty.

#### *Ofgem's response*

- 3.18 Ofgem's view is that the requirement to maintain an investment grade credit rating is consistent with the Director's duty under the Gas Act to ensure that Transco can finance its activities, since such a rating ensures that the company can access a wide range of financial markets at relatively low cost. Ofgem does not believe that the requirement is unduly restrictive.



3.19 Ofgem considers that an “issuer” rating is more relevant to a company’s financial strength than an “issue” rating, which may reflect the terms of the debt issue rather than the underlying strength of the issuer company itself. This would be particularly problematic if the relevant licensee had no debt of the type required to gauge the “issue” rating. Ofgem also believes that its proposal is less restrictive than requiring that each individual issue maintains an investment grade rating. It allows the licensee to make individual debt issues of different forms which may attract a lower rating, provided this does not undermine the licensee’s overall rating as a debt issuer. Accordingly, Ofgem believes that the requirement for an “issuer” rating should be implemented.

### **Amended Standard Condition 16**

#### ***Summary of responses***

3.20 In addition to the concerns connected with the payment of dividends mentioned under Special Condition 3 above, one respondent considered that the proposed licence condition should limit requests for information to those necessary for the fulfilment of the Director’s duties.

#### ***Ofgem’s response***

3.21 Ofgem does not consider that such a limitation is necessary since the proposed condition is already limited to information “necessary to enable the licensee to meet its obligations under the Act and under the licence to produce documentation or furnish information to the Director”.

### **Individual transactions**

#### ***Summary of responses***

3.22 Two respondents commented on this issue and raised the following issues:

- the businesses which should be subject to a consultation when moved out of BG plc; and
- the value at which the businesses should be transferred from Transco.

3.23 Both respondents who commented considered that Ofgem should conduct a consultation when ancillary businesses such as Metering or Connections were transferred to BG Energy Holdings. One respondent considered that non-ancillary businesses should also be subject to a consultation process when transferred.

3.24 One respondent argued that the businesses should be transferred from Transco at market value, rather than book value.

#### ***Ofgem’s response***

3.25 Ofgem does not consider that it should normally consult on a transfer of a non-ancillary business, because:

- if the business is not ancillary and the transfer does not involve the movement of transportation assets, the Director has no power under the

Gas Act or Transco's licence to block, or set out conditions for, such a transaction; and

- Ofgem does not have any competition law powers or duties in respect of non-ancillary businesses.

3.26 Ofgem does not consider that the value at which the businesses were transferred out needs to be considered before the next price control review. Ofgem does not consider, in approving these individual transactions, that it is making a judgement on the valuation which Transco has placed on these businesses. The value Ofgem assigns to these businesses and the rest of the BG group when setting a price control does not need to be consistent with the valuation at which these businesses have been transferred out.

## ANNEX 1: BG PLC CORPORATE RESTRUCTURING

Table of non-confidential responses to consultation document received by Ofgem

Reference	Respondent	Comments	Ofgem's response
<b>Dividend prohibition if information not provided</b>			
Licence Amendments: Special Condition 3 Paragraph 8	NGC	<ul style="list-style-type: none"> <li>- The prohibition should not be in Special Condition 3. SC 3 deals with the sufficiency of financial resources, to which this prohibition is irrelevant.</li> <li>- The prohibition is unnecessary, because the Licence could allow the Director to take enforcement action to secure information from the Licensee or related companies.</li> <li>- The prohibition is disproportionate.</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem recognise that the power is tougher than in the current PES licences.</li> <li>- Ofgem intends to make a written statement regarding the manner in which these provisions would be used.</li> </ul>
Licence Amendments: Special Condition 3 Paragraph 8	BGT	<ul style="list-style-type: none"> <li>- BGT is not convinced of the need for the prohibition on dividends</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem consider that such a power is necessary reliably to obtain the necessary information at the correct time.</li> </ul>
Licence Amendments: Special Condition 3 Paragraph 8	BG plc	<ul style="list-style-type: none"> <li>- The prohibition is disproportionate.</li> <li>- The prohibition is inconsistent with the modifications to PES licences, which provide an adequate remedy.</li> <li>- If Ofgem do not consider the electricity model adequate, a modification to the effect that the Licensee should comply with a direction from the Director to seek to enforce the undertaking from related companies to supply information should suffice.</li> <li>- If the prohibition is adopted, there should be a Code of Practice, applicable to both the gas and electricity sectors to help the regulated subsidiaries to comply with the relevant information requirements.</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem recognise that the power is tougher than in the current PES licences.</li> <li>- Ofgem intends to make a written statement regarding the manner in which these provisions would be used.</li> </ul>

Reference	Respondent	Comments	Ofgem's response
		<ul style="list-style-type: none"> <li>- Payment of dividends will not undermine the Licensee's compliance with its regulatory requirements to obtain and enforce requirements from related companies to provide information.</li> <li>- The consultation document does not sufficiently identify the Director's reasons for the prohibition</li> <li>- Section 38 of the Gas Act enables the Director to seek information from any member of the BG Group if Transco may be contravening its licence.</li> </ul>	
Licence Amendments: Special Condition 3 Paragraph 8	ScottishPower	<ul style="list-style-type: none"> <li>- The prohibition is inconsistent with the modifications to PES licences</li> <li>- The prohibition is disproportionate</li> <li>- ScottishPower is not aware of any difficulties in obtaining information from the PESs</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem recognise that the power is tougher than in the current PES licences.</li> <li>- Ofgem intends to make a written statement regarding the manner in which these provisions would be used.</li> <li>- Simply because there have been no difficulties at present, does not mean that there will not be in the future.</li> </ul>
<b>De minimis businesses</b>			
Licence Amendments: Special Condition 2 Paragraph 6	Enron	<ul style="list-style-type: none"> <li>- Transco should not be allowed to keep revenue outside the price control if that revenue accrues from assets and staff which have been funded from revenues from monopoly customers.</li> <li>- The proposed threshold of 2.5% is too high: there should not be that many stranded assets in the regulatory asset base.</li> </ul>	<ul style="list-style-type: none"> <li>- The treatment of these revenues will be considered as part of the next price control review.</li> <li>- 2.5% of turnover is one half of the PESs' de minimis threshold.</li> </ul>
Licence Amendments: Special Condition 2 Paragraph 6	ScottishPower	<ul style="list-style-type: none"> <li>- The de minimis threshold of 2.5% is inconsistent with the PES threshold of 5%. "Creeping" regulation seems to increase regulatory uncertainty</li> </ul>	<ul style="list-style-type: none"> <li>- Currently, Transco only undertakes excluded services to the value of around 0.3% of its turnover. Transco has a much larger turnover than any of the PESs. Therefore, 2.5% of Transco's turnover is</li> </ul>

Reference	Respondent	Comments	Ofgem's response
			much larger than 5% of any PES. Ofgem intends to consult separately on the appropriate future threshold for electricity distribution businesses.
Licence Amendments: Special Condition 2	Scottish and Southern Energy	- Transco should not be prevented from using existing resources in new activities where this can give rise to benefits for customers.	- The provision will allow Transco to provide such services within certain limits.
<b>Investment grade credit rating</b>			
Licence Amendments: Special Condition 4 Paragraph 1	ScottishPower	- Requiring an issuer rating rather than an issue rating is tougher than the PES licences. "Creeping" regulation seems to increase regulatory uncertainty.	- Ofgem believes its proposal is <i>less</i> restrictive, because it does not require all debt issues to obtain an investment-grade rating.
Licence Amendments: Special Condition 4 Paragraph 1	BGT	- The duty to maintain a specified credit rating is unduly restrictive. - Any additional cost of capital incurred by Transco from the restructuring should be borne by Transco, not the industry.	- The purpose of the duty is to ensure that Transco can access financial markets to borrow money at any time. - This restructuring is expected to lower, rather than raise, Transco's cost of capital.
<b>Cross-default obligations</b>			
Licence Amendments: Special Condition 2 Paragraph 5	ScottishPower	- Requiring a counter-indemnity from a related company for cross-default obligations is tougher than the prohibition on cross-default obligations with transitional provisions in the PES licenses.	- Ofgem disagrees: this requirement was inserted at BG's request to deal with those obligations which could not realistically be moved.
Licence Amendments: Special Condition 2 Paragraph 5	Scottish and Southern Energy	- It is sensible to allow BG to retain guarantees within Transco, provided that those guarantees are counter-indemnified by a party which retains an investment-grade credit rating.	- Ofgem agrees
<i>3.26.1.1.1.1 Value of businesses to be transferred out of Transco</i>			
Section 5	Enron	- The value of the assets to be transferred out of	- The value of the assets which are

Reference	Respondent	Comments	Ofgem's response
		Transco should reflect the market value, rather than the book value, of those assets. It is inappropriate that Transco and its customers should pay for an asset, and yet receive only part of the revenues which the asset generates.	transferred out will only become relevant at the next price control review. Ofgem will consider the value at which the assets were transferred out at that time, in its determination of Transco's regulatory asset value.
<b>Ancillary services</b>			
Annex 5	BGT	<ul style="list-style-type: none"> <li>- Where ancillary businesses are transferred out, there should be a separate consultation process.</li> <li>- BGT has no objection to the transfer of the non-ancillary businesses.</li> <li>- BGT supports the process outlined in Annex 3</li> </ul>	- Ofgem agrees
Section 5	BP Amoco	- Any movement of an ancillary business should be subject to consultation, as Ofgem argues	- Ofgem agrees
Section 5	Enron	- Unbundling of non-ancillary business should be subject to a consultation process.	- Ofgem disagrees: there is no provision in the Act or the Licence requiring Transco to consult Ofgem if it moves a non-ancillary business, and such a policy would be inconsistent with Ofgem's policy of allowing the non-regulated parts of BG as much commercial freedom as possible.
<b>Overall aims of restructuring</b>			
Sections 1 and 2	BP Amoco	- BP Amoco is supportive of the overall aims of the restructuring.	- Ofgem agrees
<b>Regulatory transparency and consistency</b>			
Sections 2 and 5	BP Amoco	<ul style="list-style-type: none"> <li>- The restructuring appears to increase regulatory transparency and Transco's financial efficiency.</li> <li>- The restructuring appears to allow Transco to procure services, but Ofgem should continue to ensure no</li> </ul>	- Ofgem agrees, and powers to ensure no cross-subsidy are already in Amended Standard Condition 11

Reference	Respondent	Comments	Ofgem's response
		cross-subsidy or unfair competition	
Section 4.1-4.9 and Annex 2	BGT	- Regulatory transparency and consistency should not prevent Transco from carrying on businesses other than the "Transco business" or "de minimis" businesses	- Ofgem considers that Transco should only carry on transportation or storage, or closely related activities, in order to avoid the regulatory asset base being jeopardised by possible liabilities in other areas.
Licence Amendments: Special Condition 4 Paragraph 1	Scottish and Southern Energy	- The regulator must do its part to contribute to the climate of consistency in price control reviews by adopting a predictable methodology.	- While Ofgem is aware of the benefits of regulatory consistency and predictability, it must have regard to the Director's other duties, such as securing effective competition or promoting efficiency and economy in gas transportation.
<b>Cross-subsidy</b>			
Section 2	BP Amoco	- Transco's earnings could be used to mask the under-performance of other parts BG plc - The benefits of increased efficiency should be shared with Transco's customers before the next price control review	- BG's dealings with its shareholders are not Ofgem's concern. - Ofgem will not reopen the current price control, because reducing BG's allowed revenue as a result of this transaction would remove incentives on BG to improve efficiency in the future.
<b>Price control issues</b>			
Section 2.1-2.14	BGT	- Ofgem should not reopen the current price control, but should take into account any savings which BG makes in setting the next price control.	- Ofgem agrees.
Section 2.12-2.14	Enron	- Ofgem should not reward BG at the next price control for standard business practice in setting an efficient capital structure; - Ofgem should take account of the most efficient capital structure for BG and not the capital structure	- Ofgem will consider the appropriate way to derive a cost of capital for Transco at the next price control review.

Reference	Respondent	Comments	Ofgem's response
		which BG has in place at that time.	
Section 2.12-2.13	Scottish and Southern Energy	<ul style="list-style-type: none"> <li>- The current price control should not be reopened, to preserve the incentives on Transco to be efficient</li> <li>- The costs of the introduction of the restructuring should be recognised at the next price control review.</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem agrees that the current price control should not be reopened.</li> <li>- Ofgem disagrees that the costs of the introduction of the restructuring should be recognised. Shareholders have benefited during the period of the current price control. This should be recognised in the next review, and the benefits passed to consumers.</li> </ul>
<b>Provision of common services</b>			
	Enron	<ul style="list-style-type: none"> <li>- Where common service businesses have developed products using Transco generated expertise or assets (for example, "Transcost") there should be a discussion about the appropriate transfer payment which should be made to Transco to reflect this usage.</li> <li>- Where transportation revenue has been used to fund common services businesses, the benefits of such investment should be payable to Transco's consumers. Examples of this are BG Property and The Leasing Group.</li> </ul>	<ul style="list-style-type: none"> <li>- Amended Standard Condition 11 requires that Transco should conduct its business to ensure that no other entity obtains an unfair commercial advantage. Ofgem considers this safeguard sufficient.</li> </ul>
<b>Further restructuring</b>			
<b>Scheme of Arrangement</b>			
Section 3	BGT	<ul style="list-style-type: none"> <li>- Ofgem should approve the Scheme</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem agrees</li> </ul>
Section 3	Scottish and Southern Energy	<ul style="list-style-type: none"> <li>- Ofgem should approve the Scheme</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem agrees</li> </ul>
<b>Provision of information</b>			
Licence	BGT	<ul style="list-style-type: none"> <li>- The provision of information to the Director should</li> </ul>	<ul style="list-style-type: none"> <li>- Ofgem considers such a restriction</li> </ul>



Reference	Respondent	Comments	Ofgem's response
Amendments: Amended Standard Condition 16		only apply if the information is requested in the fulfilment of the Director's duties.	redundant, as the condition is limited to existing obligations to provide information to the Director.
<b>Disposal of Assets</b>			
Section 4.28-4.29	BGT	<ul style="list-style-type: none"> <li>- The proposed amendment to Standard Condition 25 is unnecessary</li> <li>- A control around the intra-Group transfer of costs and to ensure clarity in the regulatory accounts is necessary. This should be achieved in the process for moving businesses outlined by Ofgem.</li> </ul>	<ul style="list-style-type: none"> <li>- Amended Standard Condition 25 is necessary to ensure that the Licensee has at all times the assets necessary to fulfil its duties.</li> <li>- Ofgem considers that the safeguards in Amended Standard Conditions 2 and 11 are sufficient.</li> </ul>
<b>Provision of adequate staff and resources for Transco</b>			
Licence Amendments: Special Condition 3	BGT	- BGT support the provisions of Special Condition 3 requiring Transco to procure a legal undertaking from the ultimate holding company not to cause Transco to breach the Act or the Licence.	- Ofgem agrees
Licence Amendments: Special Condition 3	Scottish and Southern Energy	- There is no need to have regulations dictating the staff and resources for Transco. The company should be regulated by results.	- The regulations are there as a precautionary measure, since any enforcement measures will be too late.

The following respondents had no comment outline issues raised in the consultation document: the Health and Safety Executive, the Consumers Association, the Gas Consumers Council and the Scottish Consumers Council.



# Gas Act 1986

## Section 23

### **Modification of 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 Section 23(1)(a) of the Gas Act 1986 and with the consent of BG plc, hereby modifies, in the manner set out in the Schedule hereto, the standard conditions and special conditions of the licence treated as granted under Section 7 of the Gas Act 1986 to BG plc.

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

13 December 1999

## Schedule

### MODIFICATIONS TO THE SPECIAL CONDITIONS

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 interest in land in respect of which no related person of the Licensee other than a subsidiary of the Licensee has received or may receive any profit on its disposal shall not be regarded as a Cross-Default Obligation.”

- (a) 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 sub-paragraphs (a) - (c), any payment or transaction lawfully made or undertaken by the Licensee for a purpose within sub-paragraphs (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 Court on 6 December 1999 and becoming effective on 13 December 1999;
- "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 for a purpose within sub-paragraphs (a), (b), or (c) of the definition of Permitted Purpose;
  - (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 of all investments (determined in accordance with sub-paragraph (c) below) made by the Licensee or any of its subsidiaries in all the de-minimis businesses 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 consolidated financial statement then available; and
  - (iii) the business is conducted employing persons or assets first employed or acquired for a purpose within sub-paragraph (a) of the definition of Permitted Purpose.
- (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 or any of its subsidiaries 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; and “Transportation and LNG Storage Business” has the meaning given to that expression in Amended Standard Condition 2(9).
- (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 or any of its subsidiaries in respect of such investment in all completed accounting reference periods since such accounting reference date,
- (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 or any of its subsidiaries relating to such investment outstanding at the end of the most recently completed accounting reference period, and
- (iv) the amount of any dividends (if any) paid by that business or activity in all completed accounting reference periods since such reference date,

less the sum of:

- (v) the amount of turnover generated by that business or activity in all completed accounting reference periods since such accounting reference date; and
  - (vi) the value of disposal proceeds on disposal of that business by the Licensee or a subsidiary of the Licensee other than to a subsidiary of the Licensee
- (d) 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 to the Director 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) 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.

#### **MODIFICATIONS TO THE STANDARD CONDITIONS**

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  
“(a) each 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); or
- (iii) 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) each be accompanied by 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 the redesignated sub-paragraph (3)(e) substitute “sub-paragraph (c)” for “sub-paragraph (b)” and “sub-paragraph (e)” for “sub-paragraph (d)”
- (h) In paragraph (7) delete the words “any accounting statement for a Common Service Business or”;
- (i) 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 any Ultimate Holding Company of the Licensee or any subsidiary of any Ultimate Holding Company; or

(b) any of the statements referred to in sub-paragraph 3(b) of this Condition. “;

(j) in paragraph (9)

(i) delete the definition of “Common Service Business”,

(ii) in the definition of “Separate Business” delete “(e)” and insert “(d)”, and

(iii) amend the definition of “the TransCo Business” to read  
“the TransCo Business” means business carried on by the Licensee for a purpose within sub-paragraphs (a) and (b) of the definition of “Permitted Purpose;”.

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 any such commitment is made no later than 12 months from the Relevant Date;
  - (b) transfer, lease, license 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, license 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 paragraph 3 of Special Condition 2; 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."