

DIRECTION ISSUED PURSUANT TO AMENDED STANDARD CONDITION 29 (DISPOSAL OF ASSETS) OF THE ORIGINAL TRANSCO GAS TRANSPORTERS LICENCE AND PURSUANT TO PARAGRAPH 3 OF SCHEDULE 3 TO THE GAS ACT 1986 RELATING TO THE PROPOSED DISPOSAL BY TRANSCO OF THE WALES AND WEST DISTRIBUTION NETWORK TRANSPORTATION ASSETS AND CERTAIN LAND TO BLACKWATER 2 LIMITED

Background

1. This Direction is issued by the Gas and Electricity Markets Authority (the "Authority") in connection with National Grid Transco plc's ("NGT") proposed sale of one or more of Transco plc's ("Transco") local gas distribution networks ("DNs") (the "Proposed Transaction").
2. Transco (registered in England and Wales with company number 2006000 and whose registered office is at 1-3 Strand, London WC2N 5EH) is the holder of a gas transporters ("GT") licence treated as granted under Section 7 of the Gas Act 1986 (the "Act") which was amended and restated by a licensing scheme made by the Secretary of State for Trade and Industry (the "Secretary of State") pursuant to paragraph 19 of Schedule 7 to the Utilities Act 2000 on 28 September 2001 (the "Original Transco Licence").
3. Blackwater 2 Limited (registered in England with company number 5046791 and whose registered office is at 1-3 Strand, London, WC2N 5EH) is a wholly owned subsidiary of Transco (the "Company"). Transco has informed the Authority that save for:
 - various arrangements related to its incorporation;
 - various contracts relating to the Proposed Transaction; and
 - arrangements to amend its share capital in relation to the Proposed Transactionas at the date of this Direction, the Company has never traded and has no assets or liabilities whatsoever.
4. Transco has informed the Authority that in August 2004, it entered into conditional agreements with a number of bidders in connection with the Proposed Transaction (the "Purchasers"). One of these Purchasers was a consortium comprising Macquarie Bank Limited, Macquarie European Infrastructure Fund LP, Development Australia Fund Management Limited (as trustee of the Infrastructure Unit of the pooled superannuation trust known as Development Australia Fund), Northwestern Mutual Life Insurance Company,

Macquarie Global Infrastructure Fund II, Challenger Life No.2 Limited, AMP Life Limited and Canada Pension Plan Investment Board. This consortium is proposing to indirectly (through the acquisition from Transco of the entire issued share capital of the Company) acquire the Distribution Network Business (as such term is defined in paragraph 26 below).

5. On 5 November 2004 (pursuant to applications from Transco in connection with the Proposed Transaction), the Authority (without in any way fettering its discretion in relation to the Proposed Transaction) granted five additional GT licences to Transco (the "Additional Transco Licences"). As a result of this, Transco currently holds in total six GT licences. The Additional Transco Licences were granted and remain in substantially the same form as the Original Transco Licence. The Original Transco Licence and the Additional Transco Licences are together referred to in this Direction as the "Transco Licences".
6. As at the date of this Direction, all gas transportation assets owned by Transco are operated pursuant to the Original Transco Licence. As at the date of this Direction, the Additional Transco Licences, whilst active, do not relate to any particular gas transportation assets owned or operated by Transco.
7. On 25 November 2004, the Authority (without in any way fettering its discretion in relation to the Proposed Transaction), published a notice pursuant to Section 23 of the Act proposing, in connection with the Proposed Transaction, to modify each of the Transco Licences in the manner set out in the notice to separate the price controls (as currently set out in the Original Transco Licence) (the "Initial S23 Modifications"). The intention behind the proposals set out in the Initial S23 Modifications notice is to achieve revenue separation between the NTS (as such term is defined in paragraph 26 below) and each of the four DNs which are proposed to be disposed of by Transco as part of the Proposed Transaction (the "IDNs") and each of the four DNs which are proposed to be retained by Transco (the "RDNs"). If the modifications proposed in the Initial S23 Modifications notice are made, four of the Additional Transco Licences will each relate to a specific IDN respectively; one of the Additional Transco Licences will relate to the four RDNs only and the Original Transco Licence will relate to the NTS only.
8. Accordingly, subject to the Authority making the necessary directions, one of the Additional Transco Licences is envisaged by Transco to have been amended, among other things, so that it is applicable to the Distribution Network Business only.

Hive-down

9. As part of the Proposed Transaction, Transco is proposing to “hive-down” each of the four IDN businesses (one of which is the Distribution Network Business) to four separate wholly owned Transco subsidiary companies (one of which is the Company). The proposed hive-downs by Transco will require, inter alia, the consent of the Secretary of State and the Authority pursuant to Amended Standard Condition 29 of the Original Transco Licence. It was made clear in the Initial S23 Modifications notice relating to the separation of the price controls that the proposed Initial S23 Modifications to the Transco Licences would not be directed by the Authority in the event that Transco does not obtain the consents necessary to undertake the hive-down of the IDNs from Transco to the wholly owned Transco subsidiary companies. Transco is seeking to hive-down the Distribution Network Business to its wholly-owned subsidiary, the Company.

Licence Transfer

10. In addition, in order to facilitate the proposed hive-downs, Transco is also proposing (pursuant to Section 8AA of the Act) to transfer each of the four Additional Transco Licences (which, if the Initial S23 Modifications relating to the separation of the price controls are made will relate to each of the four IDNs respectively) to the four wholly owned Transco subsidiary companies (one of which is the Company) respectively. It is proposed that each of these four Additional Transco Licences be further modified as part of any consent from the Authority to transfer (the “S8AA Modifications”). In conjunction with this, it is also proposed that:

- the Original Transco Licence (which, if the Initial S23 Modifications relating to the separation of the price controls are made will relate to the NTS only) be further modified; and
- the one Additional Transco Licence (which, if the Initial S23 Modifications relating to the separation of the price controls are made will relate to the RDNs only) be further modified.

It is proposed that such further modifications to the Original Transco Licence and this one Additional Transco Licence be proposed pursuant to a S23 notice which would be published in conjunction with the 8AA Modifications notice (the “Second S23 Modifications”).

11. Accordingly, it is proposed that at the same time as the Distribution Network Business is hived-down to the Company, Transco will also transfer the Additional Transco Licence which it envisages will at that stage relate only to the Distribution Network Business to the Company, provided that it has received:

- the consent of the Authority under Section 8AA of the Act; and
- the consent of the Secretary of State under Special Condition 25A of the Original Transco Licence.

12. On 11 January 2005, Transco wrote to the Authority seeking consent under Section 8AA of the Act to the transfer each of the four Additional Transco Licenses (which if the Initial S23 Modifications relating to the separation of the price controls are made will relate to each of the four IDN respectively) to the four wholly owned Transco subsidiary companies (one of which is the Company) respectively. It has separately also sought consent from the Secretary of State.

Uniform Network Code

13. As part of the Proposed Transaction, it is intended by Transco that its existing Network Code will be modified to create a Uniform Network Code (the "UNC"). Transco will need to raise a modification proposal (the "Transco Network Code Modification Proposal") seeking to achieve this. The Transco Network Code Modification Proposal is expected to seek to convert the Transco Network Code into Transco's "Short Form Network Code". In order to create Transco's Short Form Network Code, the Transco Network Code Modification Proposal is expected to seek to delete all the substantive content of the Transco Network Code and is expected to incorporate by reference, the business rules in a Uniform Network Code (the "UNC") that would apply to the NTS and the DNs. It is proposed that the UNC would be developed to define the rights and obligations of gas transporters operating networks which are, as at the date of this Direction defined collectively in the Transco Network Code as the "System".

14. If the Distribution Network Business is hived-down to the Company and subject to:

- the satisfaction by Transco of the conditions which are attached to the Authority's consent to the disposal of the Transportation Assets (as such term is defined in paragraph 26 below) to the Company;

- the acceptance by the Health and Safety Executive of a safety case in respect of the Company under the Gas Safety (Management) Regulations 1996; and
- Transco obtaining the necessary consent from the Secretary of State under Amended Standard Condition 29 of the Original Transco Licence to the Proposed Disposal,

then Transco proposes that the entire issued share capital of the Company be sold to third party purchasers.

Request for Consent

15. In light of the above Transco proposals, by a letter dated 11 January 2005 (the "Application"), Transco informed the Authority that the consents described below will be required from the Authority:

- (a) Consent under Amended Standard Condition 29 of the Original Transco Licence to permit Transco to dispose of and relinquish operational control over the Transportation Assets to the Company;

Transco asked the Authority to regard the letter as notice of, and request for consent to, Transco's proposed disposal of, and relinquishing of operational control over, Transportation Assets to the Company not earlier than 1 May 2005, pursuant to paragraph 2 of Amended Standard Condition 29 of the Original Transco Licence (the "Proposed Transportation Assets Disposal").

Amended Standard Condition 29 of the Original Transco Licence permits the proposed disposal to take place if the Authority does not inform Transco in writing of any objection to Transco's disposal notice within 2 months. Transco stated that it would, however, prefer an affirmative consent from the Authority.

- (b) Consent under paragraph 3 of Schedule 3 to the Act to permit Transco to dispose of such land as it has purchased compulsorily which falls within the assets of the Distribution Network Business to the Company (the "Proposed Land Disposal").

16. The Proposed Transportation Assets Disposal and the Proposed Land Disposal are together referred to in this Direction as the "Proposed Disposal".

17. Transco is, by separate letters submitted to the Authority at the same time as the Application referred to above and to which this Direction relates, also seeking similar consents from the Authority in relation to the proposed disposal of each of the other three IDNs to three other wholly owned Transco subsidiary companies respectively.

Consent

18. Having carefully considered Transco's request and respondents' views and having had regard to the relevant papers and to its principal objective and statutory and other duties, pursuant to paragraph 4(a) of Amended Standard Condition 29 of the Original Transco Licence and paragraph 3 of Schedule 3 to the Act, the Authority hereby directs that subject to the conditions set out in this Direction, Transco may undertake the Proposed Disposal not earlier than 1 May 2005.
19. The consent set out in this Direction is subject to conditions in two parts: conditions precedent and conditions subsequent. Both sets of conditions must be satisfied for the consent to be effective.
20. Having carefully considered Transco's request and respondents' views and having had regard to the relevant papers and to its principal objective and statutory and other duties, the Authority is of the view that each of the conditions set out in this Direction is reasonable and proportionate and consistent with its principal objective and statutory and other duties including without limitation necessary to ensure that the interests of customers are protected. The consent contained in this Direction together with each of the conditions are intended to be construed as a composite. If any of those conditions is determined to be invalid in whole or in part, its invalidity shall affect the validity of the consent granted pursuant to this Direction.

Conditions precedent

21. The consent of the Authority set out in this Direction is in all respects conditional upon and shall not in any way become effective unless and until:
- (a) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the proposed modifications to each of the Transco Licences as largely set out in the Initial S23 Modifications notice relating to the separation of the price controls and such licence modifications having become effective;

- (b) Transco having consented in writing to and the Authority (not having received a direction from the Secretary of State not to make any modification) having directed in writing the S8AA Modifications to each of the four relevant Additional Transco Licences (which Transco envisages will at the relevant time relate to each of the four IDNs respectively only) and the Second S23 Modifications to the Original Transco Licence (which Transco envisages will at the relevant time relate to the NTS only) and the one relevant Additional Transco Licence (which Transco envisages will at the relevant time relate to the four RDNs only) and in each case such licence modifications having become effective;
- (c) The Authority having consented (pursuant to Section 8AA of the Act) in writing to the transfer of the each of four Additional Transco Licences each of which Transco envisages will at the relevant time relate to one of the four IDNs respectively only and Transco having actually transferred one of those licences to each of Transco's four relevant wholly owned subsidiaries (one of which is the Company) respectively in accordance with the Authority's consent;
- (d) The Authority being satisfied as to the proposed arrangements as part of the Proposed Transaction for industry codes, including without limitation the UNC and various network codes and (again without limitation) the Authority having directed the Transco Network Code Modification Proposal to be implemented as it better facilitates the relevant code objectives (as defined in the Original Transco Licence) and consequently the modifications to the Transco Network Code having become effective;
- (e) The Health and Safety Executive having received safety cases in respect of each of Transco's four relevant wholly owned subsidiary companies (one of which is the Company) (for each of the four IDNs proposed to be hived-down to each one respectively (one of which is the Distribution Network Business)) and in respect of Transco (for the NTS and the RDNs) and each of those safety cases having been accepted by the Health and Safety Executive pursuant to the Gas Safety (Management) Regulations 1996;
- (f) The Secretary of State having granted her consent to the proposed hive-down of each of the four IDNs (one of which is the Distribution Network Business) pursuant to Amended Standard Condition 29 of the Original Transco Licence to each of the four

relevant Transco wholly owned subsidiary companies (one of which is the Company) and such consents having unconditionally come into full effect;

- (g) The Secretary of State in the exercise of the powers conferred upon her by Section 6A of the Act having, in connection with the Proposed Transaction, made an Order granting an exemption to certain gas transporters in respect of certain gas shipping arrangements as described in the consultation document issued by the Department of Trade and Industry on 19 November 2004 and such Order coming into full force and effect;
- (h) Within seven days from the date of this Direction, Transco having procured from NGT an undertaking addressed to the Authority in the form specified by the Authority that NGT will:
 - i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of NGT (including for the avoidance of doubt, Transco and its subsidiaries) will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
 - ii. from the date of such undertaking until the date on which the S8AA Modifications and the Second S23 Modifications become effective use its best endeavours to ensure that Transco and, during the period that Transco is the legal or beneficial owner of share capital of the four relevant wholly owned Transco subsidiary companies (one of which is the Company), each such subsidiary company (including the Company) takes steps to implement by 1 September 2005 the enduring offtake arrangements as described in the Authority's Final Impact Assessment in relation to the Proposed Transaction in November 2004¹ (the "Enduring Offtake Arrangements") in a format approved by the Authority;
- (i) Within twenty eight days from the date of this Direction, Transco having procured from each of the Purchasers an undertaking addressed to the Authority in the form specified by the Authority that the Purchaser will:

¹ National Grid Transco – Potential sale of gas distribution network businesses. Final Impact Assessment. November 2004 255/04a

- i. At all times refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of the Purchaser will refrain from any action, which would be likely to cause Transco to breach any of its obligations under this Direction or which would be likely to prevent Transco taking appropriate steps to satisfy any conditions to consent contained in this Direction; and
 - ii. from the date of such undertaking until the date on which the relevant Purchaser becomes (directly or indirectly) the legal or beneficial owner of the share capital of a relevant Transco subsidiary company (one of which is the Company), use its best endeavours to ensure that such company takes steps to implement by 1 September 2005 the Enduring Offtake Arrangements in a format approved by the Authority;
- (j) The proposed hive-down of the IDNs (one of which is the Distribution Network Business) from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) being consistent with all applicable conditions contained in the Original Transco Licence; and
- (k) Any other consent, clearance, permission, authorisation or approval required under statute, the Original Transco Licence or otherwise in respect of the proposed hive-down of the IDNs (one of which is the Distribution Network Business) from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) having been unconditionally obtained.
22. If any of the conditions set out in paragraph 21 above and sub-paragraph 23(a) below are not satisfied in full by 1 May 2005 or if at any stage prior to that date the Authority is of the opinion that any such condition is unlikely to be satisfied by that date, the Authority shall be entitled at its sole discretion to:
- (a) waive the unsatisfied condition or conditions;
 - (b) extend the period for satisfying the unsatisfied condition or conditions to an alternative date; or
 - (c) vary or otherwise modify any unsatisfied condition or conditions.

Conditions subsequent

23. In addition to the conditions in paragraph 21, the consent of the Authority set out in this Direction is in all respects conditional upon the following:

- (a) Transco shall complete the proposed hive-down of the four IDNs (one of which is the Distribution Network Business) from Transco to each of the four relevant wholly owned Transco subsidiary companies (one of which is the Company) pursuant to the consent set out in this Direction not earlier than 1 May 2005;
- (b) Under NGT's commercial timetable for the Proposed Transaction, at the time that the Proposed Disposal is expected to complete, the regulatory, commercial and operational arrangements which in the Authority's opinion will be necessary to protect the interests of customers in the context of the Proposed Transaction will not be in place. Transco shall therefore retain the legal and beneficial ownership of the entire issued share capital of the Company and shall not directly or indirectly dispose of such shares or in any way relinquish control directly or indirectly over the Company without the Authority's prior written consent. For the purposes of this sub-paragraph "dispose" shall include, without limitation, any sale, gift, exchange, standard security, mortgage, pledge, lien, hypothec charge, loan, option, right to acquire or other encumbrance or third party right (in each case given, granted or allowed to arise or subsist under any applicable law and any licence, lease, assignation, assignment or other agreement (in each case made or entered into under any applicable law) and "disposal" and cognate expressions shall be construed accordingly;
- (c) Under NGT's commercial timetable for the Proposed Transaction, at the time that the Proposed Disposal is expected to complete, the regulatory, commercial and operational arrangements which in the Authority's opinion will be necessary to protect the interests of customers in the context of the Proposed Transaction will not be in place. Transco shall therefore on or before the satisfaction of sub-paragraph (b) provide its written consent (and whilst it is the legal or beneficial owner of the share capital of the Company shall procure that the Company shall provide its written consent) in a form approved by the Authority:
 - (i) to any subsequent licence modifications; and

- (ii) to implement, or with the prior written agreement of the Authority, to take steps to implement, such other changes relating to all regulatory, commercial or operational arrangements

in order to enable the Proposed Transaction to proceed and which in the case of each of (i) and (ii) (above), the Authority has prior to the satisfaction of sub-paragraph (b) notified Transco that it considers to be necessary in order to ensure that the Proposed Transaction and associated regulatory, commercial and operational reforms are implemented in a manner which the Authority considers is consistent with its principal objective and its statutory and other duties, including without limitation, to ensure that the interests of present and future customers are protected in a divested industry; and

- (d) Transco shall ensure (and whilst it is the legal or beneficial owner of the share capital of the Company, shall procure that the Company shall ensure) that where any condition has been satisfied, it shall take no action which would result in such condition not being satisfied had it not already been satisfied.

24. Transco shall (and whilst it is the legal or beneficial owner of the share capital of the Company shall procure that the Company shall), inform the Authority immediately in writing, if it becomes aware of any material change in circumstances regarding the information on which the consent contained in this Direction is based or any other material change in circumstances regarding the Proposed Transaction or any change in relation to any of the conditions to consent contained in this Direction.

25. The consent given by this Direction applies only for the purpose of the said Amended Standard Condition 29 of the Original Transco Licence and paragraph 3 of Schedule 3 to the Act and shall not apply or be deemed to apply for any other purpose.

Definitions

26. In this Direction, unless the context otherwise requires:

“Distribution Network” means that area known as the Wales North, Wales South and South West LDZs as shown in the Ten Year Statement.

“Distribution Network Business” means the business of the conveyance of gas carried on by Transco within the Distribution Network from the NTS/LDZ Offtake to each point of offtake (such phrase having the same meaning as that set out in Section J, paragraph 3.7 of the Transco Network Code) from the Pipes immediately prior to the disposal to its wholly owned subsidiary, the Company, of those assets, together with all other activities within the Distribution Network that are authorised under the Original Transco Licence relating to the Distribution Network, but, for the avoidance of doubt, not the NTS, together with all income deriving therefrom after the disposal of those assets to the Company.

“NTS” means the national transmission system of Transco having the meaning given to that term in the Transco Network Code.

“NTS/LDZ Offtake” means a point at which gas flows out of the NTS and enters the Pipes and which is more particularly shown on the plans in Schedule 4 to this Direction.

“Pipes” means the facilities used for the diurnal storage of gas or for the storage of gas in connection with the operation of independent systems (bearing the meaning of that expression within the Original Transco Licence) within the Distribution Network and the pipeline system operated by Transco from each NTS/LDZ Offtake to each point at which gas is offtaken (such phrase having the same meaning as that set out in Section J, paragraph 3.7 of the Transco Network Code) from that pipeline system within the Distribution Network together with all apparatus ancillary thereto and all decommissioned pipes formerly used for the conveyance of gas within the Distribution Network including those Pipes outside the Distribution Network more particularly shown on the plans in Schedule 1 to this Direction but excluding those Pipes within the Distribution Network more particularly shown on the plans in Schedule 2 to this Direction together with those Pipes more particularly shown on the plans in Schedule 3 to this Direction.

“Ten Year Statement” means the document prevailing at the date of this Direction and prepared from time to time by Transco pursuant to Amended Standard Condition 25 of the Original Transco Licence.

“Transco Network Code” means the document prepared by Transco under paragraph 2(a) of Amended Standard Condition 9 of the Original Transco Licence as at the date of this Direction.

"Transportation Assets" means the Pipes together with any estate or interest in land required for utilisation of the Pipes.

Dated 31 January 2005

Signed Alistair Buchanan

Alistair Buchanan

duly authorised by the Authority



SCHEDULE 1