

# National Grid's sale of Gas Distribution Network business – decision on regulatory aspects and the transfer of assets

## Final decision

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### Overview:

On 10 November 2015, National Grid plc (NG) announced it intended to sell a majority of its shares in its gas distribution business. In preparation for this, NG intends to transfer its distribution assets and distribution licence from National Grid Gas plc to a new subsidiary company (NewCo). The Authority has a role in deciding whether to consent to these transfers.

In May 2016, we published a consultation document which described our role in the sale process and sought stakeholder views on issues arising from the potential transfers, ahead of any consent to transfers being given by the Authority. This document:

- summarises responses we received to our May 2016 consultation;
- sets out our decisions in each area;
- sets out our decision to consent to the transfer of assets to NewCo; and
- sets out next steps we intend to undertake.

## Context

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Gas is transported through the National Transmission System (NTS)<sup>1</sup> and then through eight gas distribution networks (GDNs) to reach around 22 million households and businesses in Great Britain. Each GDN covers a separate region.

Before 1 June 2005, all eight GDNs were owned by National Grid Gas plc (NGG) a subsidiary of National Grid plc (NG). On 1 June 2005, NGG sold four of the eight GDNs. The eight GDNs are now operated by NGG (its remaining four), Northern Gas Networks (one), Scotia Gas Networks (two) and Wales & West Utilities (one)<sup>2</sup>.

NG announced in November 2015 its intention to sell a majority stake in its gas distribution business which owns and operates its remaining four GDNs, serving 10.9 million gas consumers.

We regulate the GDNs, as they have a monopoly over each region they serve, to ensure consumers receive the service they need at an efficient cost. We do so using the RIIO (Revenue = Incentives + Innovation + Outputs) price control model.

In preparation for this proposed sale, NGG seeks to transfer the assets and licence of its gas distribution business to a new subsidiary company, National Grid Gas Distribution Limited (NewCo)<sup>3</sup>. The Authority has a role in deciding whether to consent to these proposed transfers.

NGG has obligations with respect to its gas distribution business that cut across all GDNs (eg in providing the emergency call handling service on behalf of all GDNs and acting as the backstop meter provider of last resort). In anticipation of receiving requests from NGG to transfer the gas distribution assets and licence to NewCo, in May 2016, we published a consultation document, inviting comments on: issues arising from the potential transfers; conditions to which any consent for the transfer of assets may be given; and the potential licence modifications. This document sets out our decisions in each area, our decision on the transfer of assets to NewCo and next steps.

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<sup>1</sup> NTS is owned and operated by National Grid Gas plc.

<sup>2</sup> The four GDN operators are owned by three independent ownership groups as NGN and WWU are majority owned by Cheung Kong Infrastructure (CKI).

<sup>3</sup> NG has established National Grid Gas Distribution Limited (NGGDL) for this purpose. For consistency of terminology with our consultation document, we refer to NewCo in this decision document, rather than NGGDL.

## Associated documents

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### Ofgem documents

National Grid's sale of Gas Distribution Network business – consultation on regulatory aspects, 3 May 2016.

[https://www.ofgem.gov.uk/system/files/docs/2016/05/160503\\_gdn\\_sale\\_con\\_doc\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/05/160503_gdn_sale_con_doc_final.pdf)

Statutory Consultation on proposed new standard special conditions and special conditions in National Grid Gas plc's National Transmission System (NTS) gas transporter licence, 3 May 2016.

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

Ofgem Open Letter: Sale of National Grid's Gas Distribution Network Business, 17 February 2016.

[https://www.ofgem.gov.uk/system/files/docs/2016/02/open\\_letter\\_feb\\_2016\\_final\\_pub.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/02/open_letter_feb_2016_final_pub.pdf)

Ofgem Decision Letter: Modification of National Grid Gas plc (NGG) National Transmission System (NTS)'s gas transporter licence to add dormant back stop meter provider of last resort (BMPOLR) obligations, 6 July 2016.

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

### National Grid documents

National Grid, Sale of a majority stake in National Grid's Gas Distribution Network business: Response Document, April 2016.

<http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=8589934819>

National Grid, Stakeholder consultation - Sale of a majority stake in National Grid's Gas Distribution Network business, 16 February 2016.

<http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=45406>



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## Executive Summary

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### National Grid's proposed sale

On 10 November 2015, National Grid plc (NG) announced it was starting the process of selling a majority of its shares in its gas distribution business, currently owned by a subsidiary of NG, National Grid Gas plc (NGG). This business currently serves 10.9 million households and businesses.

This process of sale would consist of two stages: stage 1, **hive across** – NG would transfer its gas distribution assets and licence from NGG to another subsidiary of NG (NewCo); and stage 2, **share sale** – NG would then sell a majority of its shares in the newly licensed NewCo.

### The Authority's role

The Authority's<sup>4</sup> formal role in the process is in stage 1 (hive across). We have to decide whether to:

- consent to the transfer of the gas distribution network assets from NGG to NewCo<sup>5</sup> - this document sets out our decision on this matter;
- consent to the transfer of and modification of the gas distribution licence from NGG to NewCo<sup>6</sup> - this document sets out our decisions on the licence issues arising from the proposed transfer, but the proposed transfer and modifications will be subject to a separate, statutory consultation, which we will publish shortly after this decision document; and
- make any modifications to NGG's transmission licence<sup>7</sup> - this documents sets out our decisions on the licence issues arising from the proposed transfer, but the proposed modifications themselves are subject to a separate, statutory consultation.

In general, we consider the transfer of assets between licensed entities (as would happen here between NGG and NewCo) to be relatively low risk. In making our decision on whether to grant consent outright, conditionally, or whether to refuse consent, we adopted an approach calculated to protect the interests of existing and future consumers. We were mindful of the need to ensure:

- relevant obligations are set out either in the distribution licence or in the transmission licence at all times;

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<sup>4</sup> The terms "the Authority", "we" and "us" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

<sup>5</sup> Under Standard Special Condition (SSC) A27 of the gas transporter licence.

<sup>6</sup> Under section 8AA of the Gas Act 1986.

<sup>7</sup> Under section 23 of the Gas Act 1986.

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- we address stakeholders' concerns on how obligations could be allocated between the transferred (distribution) licence and the retained (transmission) licence;
- the proposed allocation of assets between the transmission and the distribution licensees allows us to maintain the integrity of our price controls; and
- the relative interests of the transmission and distribution customers are fully protected.

The Authority has no formal role in stage 2 (share sale). We stated in our open letter of 25 May 2010<sup>8</sup> that *"the potential impact of mergers on our ability to regulate effectively in the interests of consumers is a legitimate factor that should be considered by the merger authorities as part of the merger assessment process."* To this end, we would *"advise the merger authorities and Government on any relevant mergers based on the relevant factors surrounding the merger in question."*

In May 2016, we published a consultation in anticipation of receiving requests from NGG to transfer the gas distribution assets and licence to NewCo. This consultation invited comments on: issues arising from the potential transfer; conditions subject to which any consent for the transfer of assets may be given; and the potential licence modifications. We received seven responses to our consultation.

### **Our decision on the transfer of gas distribution assets to NewCo**

On 23 June 2016, we received a notice from NGG requesting permission to transfer its gas distribution assets from NGG to NewCo under Standard Special Condition A27 of the distribution licence. We have decided to consent to the transfer, subject to certain conditions being met. The decision was informed by stakeholder responses to our May 2016 consultation document<sup>9</sup>. The changes are not expected to have a detrimental effect on the costs incurred by, or the services provided to, gas consumers. This decision does not fetter our discretion when deciding whether to consent to the transfer of the gas distribution licence from NGG to NewCo.

### **Next steps**

On 23 June 2016 we received a notice from NGG requesting the transfer of its distribution licence (under section 8AA of the Gas Act 1986 (the Act)). We will be shortly issuing a statutory consultation to inform our decision on whether to proceed with the proposed licence transfer and modifications.

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<sup>8</sup> 'Public statement on Ofgem's network company merger policy':

<https://www.ofgem.gov.uk/sites/default/files/docs/2010/05/merger-policy-statement.pdf>

<sup>9</sup> 'National Grid's sale of Gas Distribution Network business – consultation on regulatory aspects':

[https://www.ofgem.gov.uk/system/files/docs/2016/05/160503\\_gdn\\_sale\\_con\\_doc\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/05/160503_gdn_sale_con_doc_final.pdf)

# 1. Introduction

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## Chapter Summary

This chapter provides brief background to National Grid plc (NG)'s proposed sale of a majority stake in its gas distribution business, our role (and various other authorities' roles in) the sale process, and a summary of the purpose of this document and its structure.

## Background

1.1. There are eight gas distribution networks (GDNs) in Great Britain, each of which covers a separate region. The GDN licensees are responsible for operating, maintaining and extending the networks, for taking gas from the high pressure National Transmission System (NTS) and for providing a 24-hour gas emergency service.

1.2. In 2014-15, the GDNs transported 508 TWh (534 TWh when corrected to seasonal normal weather conditions) of gas in the year from the NTS to around 22 million homes and businesses in Great Britain. As these networks are regional monopolies, we set price controls for them under our RIIO<sup>10</sup> framework.

1.3. Before 1 June 2005, all eight GDNs were owned by National Grid Gas Plc (NGG)<sup>11</sup>, a subsidiary of NG. On 1 June 2005, NG sold four of its eight GDNs as follows:

- the Scotland and Southern GDNs were purchased by a consortium of SSE Plc, Borealis Infrastructure Management Inc and Ontario Teachers' Pension Plan Board.
- Wales and West GDN was purchased by Macquarie Infrastructure<sup>12</sup>.
- Northern GDN was purchased by a combination of companies associated with Li Ka Shing, notably Cheung Kong Infrastructure (CKI) and SAS Trustee Corporation.

1.4. The eight GDNs are currently held in three ownership groups: NG; CKI; and SSE (with Borealis and the Ontario Teachers' Pension Plan Board).

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<sup>10</sup> The current gas price control (referred to as RIIO-GD1) runs from 1 April 2013 to 31 March 2021. RIIO stands for: Revenue = Incentives + Innovation + Outputs.

<sup>11</sup> Operating as Transco Plc, a subsidiary of National Grid Transco Plc, at the time of sale in 2005.

<sup>12</sup> Subsequently, in 2012, Macquarie sold its interest in Wales and West to Cheung Kong Infrastructure (CKI). There was no significant formal role for the Authority in this sale.

1.5. At present, NGG holds two gas transporter licences, one for its NTS business and one for its GDN business. NGG also owns the transportation assets for both of these businesses, which, in general, are all assets between the meter supply point in the distribution network and the main entry points on the NTS system, eg meter points at gas storage facilities, gas reception terminals or gas interconnectors. Although they reside in the same entity, the NTS and GDN businesses are operated by NGG as predominantly separate entities with some shared corporate services such as human resources, information systems and finance.

## NG's proposed sale

1.6. On 10 November 2015, NG announced its intention to sell a majority stake in its gas distribution business, comprising NGG's remaining four GDNs. At that time NG indicated the proposed sale process would begin in 2016 and was likely to be completed in early 2017.

1.7. The intended sale process would consist of two broad stages:

- stage 1, **hive across**: in preparation for the intended share sale, NG has created a new wholly owned subsidiary (NewCo). NG would need to transfer the gas distribution assets and licence from NGG to NewCo. The assets that NGG proposes to transfer are those required to safely and efficiently operate its four distribution networks including transportation, land and some corporate assets. We understand that NG is targeting a hive across date of around 1 October 2016. Following this stage, subject to our consent and the consent of the Secretary of State, NG would own and operate two legally separate gas network companies: NGG, containing the NTS business, and NewCo, containing the GDN business.
- stage 2, **share sale**: following the proposed hive across, NG intends to sell a majority of its shares in NewCo.

## The Authority's role

1.8. The Authority has a formal role in stage 1 (hive across). Our involvement is required in three respects. We need to decide whether :<sup>13</sup>

- a) to consent to a transfer of the gas distribution network assets to NewCo (under Standard Special Condition (SSC) A27 of the gas distribution licence);
- b) to consent to a transfer (subject to any necessary modifications) of the gas distribution gas transporter licence to NewCo (under section 8AA of the Gas Act 1986 (the Act)); and
- c) any modifications are needed to the NTS gas transporter licence (under section 23 of the Act) in the event of a transfer of the assets and licence to NewCo, to ensure that relevant obligations are suitably allocated between NGG and NewCo for the post hive across arrangements.

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<sup>13</sup> We referred to the these requirements in our 17 February 2016 open letter: [https://www.ofgem.gov.uk/system/files/docs/2016/02/open\\_letter\\_feb\\_2016\\_final\\_pub.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/02/open_letter_feb_2016_final_pub.pdf)



## Stage 2 – share sale

1.9. We have no formal role in stage 2 of the sale process (the sale of the shares). In general, we are prepared to facilitate corporate transactions, as doing so maintains investor confidence, which is in the longer term interests of consumers. Our ring-fence and other licence protections allow us to regulate licensees irrespective of who owns their shares. However, the sale could lead to loss of independent comparators in the sector, ie a 'merger'. We stated in our open letter of 25 May 2010<sup>14</sup> that *"the potential impact of mergers on our ability to regulate effectively in the interests of consumers is a legitimate factor that should be considered by the merger authorities as part of the merger assessment process."* This remains our position. To this end, we would *"advise the merger authorities and Government on any relevant mergers based on the relevant factors surrounding the merger in question."* It would remain open to Ofgem to take account of any changes to market structure when considering its approach to RIIO-GD2<sup>15</sup>.

## Role of Secretary of State for Energy and Climate Change

1.10. The Secretary of State (SoS) for Energy and Climate Change also has a role in relation to the proposed transfer of gas transportation assets and gas distribution licence from NGG to NewCo.

1.11. Where the transportation asset comprises a significant part of the gas conveyance system in Great Britain, the licensee must provide the SoS with 60 days' notice of its proposed transfer. The SoS has 30 days within which to decide whether to veto the proposal (see SSC A27.11 of the gas transporter licence).

1.12. The Authority is required to give at least 28 days' notice to the SoS of any proposal to modify the licence upon its transfer (section 8AA(7)(b) of the Act). The SoS can veto the imposition of such a modification (section 8AA(8) of the Act).

1.13. The SoS's written consent is also required for transfer of a gas distribution licence pursuant to SSC A45.1 of the gas transporter licence. Any decision by the Authority to consent to the transfer of the gas distribution licence will therefore be subject to the SoS giving its written consent to the transfer of the gas distribution licence.

## Health and Safety Executive's role

1.14. Regulation 3 of the Gas Safety (Management) Regulations 1996 (GSMR) provides that *"no person shall convey gas in a network unless ... he has prepared a*

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<sup>14</sup> 'Public statement on Ofgem's network company merger policy':

<https://www.ofgem.gov.uk/sites/default/files/docs/2010/05/merger-policy-statement.pdf>

<sup>15</sup> Ofgem's next gas distribution price control period starting in 2021.

*safety case ... and that safety case has been accepted by the Executive*". In other words, before NewCo can operate as a gas transporter, it must prepare a safety case, submit it to the Health and Safety Executive (HSE) and have it accepted by the HSE. In order for HSE to accept a safety case it must first assess the evidence provided by the conveyor of gas and decide whether this complies with the requirements of GSMR.

1.15. The Authority is required to give at least 28 days' notice to the HSE of any proposal to consent to any proposed transfer (section 8AA(7)(a) of the Act) and of any proposal to impose a modification condition (section 8AA(7)(b) of the Act).

## **Our consultation on regulatory aspects**

1.16. On 3 May 2016 we published a consultation document, inviting comment on the:

- issues arising from the potential transfer of gas distribution transportation assets and gas distribution licence from NGG to NewCo in preparation for the proposed sale;
- conditions precedent and subsequent subject to which any consent for the transfer of such assets may be given; and
- drafts of proposed licence modifications to the distribution and transmission licences (ahead of consulting on them formally later in the process were we to consent to the asset transfer).

1.17. We received a total of seven responses to our consultation documents, from NG, Scotia Gas Networks, EDF Energy, E.ON, Scottish Power, RWE npower and SSE. All of these are published on our website<sup>16</sup>.


## **Purpose and structure of this document**

1.18. This document summarises stakeholders' responses to our consultation document, provides our views on these responses, and sets out our decisions. In particular:

- Chapter 2 summarises responses to the issues arising from the potential transfer of assets and licence identified in our consultation, and provides our decision on each of these and our decision to consent to the transfer of assets from NGG to NewCo subject to conditions.
- Chapter 3 summarises responses to our proposed conditions for the transfer of assets and sets out our decisions on these conditions.
- Chapter 4 describes our decision to proceed with proposed licence amendments through embarking on statutory consultations (to be published separately) to

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<sup>16</sup> <https://www.ofgem.gov.uk/publications-and-updates/national-grid-sale-gas-distribution-network-business-consultation-regulatory-aspects>



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transfer and modify the distribution licence and to modify the transmission licence.

- The Appendix contains our consent directions, including the conditions precedent and subsequent.

1.19. The transfer of the distribution licence (subject to appropriate modifications), if it were to occur, and modifications to the transmission licence, will be the subject of separate statutory consultations, which we expect to publish shortly after this decision document.

## 2. Decision on regulatory aspects and asset transfer

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### Chapter Summary

This chapter summarises responses from stakeholders to our consultation on identified issues from the potential hive across, our decision on each of these issues and our decision to consent to the transfer of assets from National Grid Gas plc (NGG) to NewCo, subject to conditions that are described in chapter 3.

2.1. In our consultation document of May 2016, we explained that:

2.1.1. In order to transfer the gas transportation assets (or otherwise relinquish operational control of a transportation asset), the licensee must submit a formal notice to the Authority under Standard Special Condition (SSC) A27 of the gas transporter licence. The Authority's consent can be granted subject to conditions that it specifies being met (SSC A27.10(a)). NGG issued Ofgem with notification under SSC A27 on 23 June 2016.

2.1.2. The Authority's consent is also required to transfer a licence from NGG to NewCo (section 8AA(1) of the Act). Consent can be given subject to modification being made to the distribution licence (section 8AA(4) of the Act). NGG issued Ofgem with a notice requesting consent from the Authority to transfer its gas distribution licence on 23 June 2016. The proposed transfer (subject to modification conditions) of the licence will be subject to a separate statutory consultation published shortly after this decision document.

2.2. In May 2016, we published a consultation in anticipation of receiving requests from NGG to transfer the gas distribution assets and licence to NewCo. This consultation invited comments on: issues arising from the potential transfer; conditions to which any consent for the transfer of assets may be given; and the potential licence modifications. We received seven responses to our consultation.

2.3. In our consultation document we identified several of NGG's current licence obligations which, in the event of the proposed hive across, might affect other industry stakeholders and which may need to change as a result. We described each of the obligations, summarised NGG's proposals and the responses it received from stakeholders through its own consultation (where NGG consulted on it) before setting out our initial view. We invited stakeholders' comments on our views and on any

other concerns regarding NGG's obligations that are potentially affected by the proposed hive across. The obligations of NGG we considered were in relation to:

- Backstop Meter Provider of Last Resort (BMPOLR)
- Xoserve
- Joint Office of Gas Transporters
- 0800 Gas Emergency number
- Legal entity separation and compliance officer role.

2.4. In this chapter, for each of the obligations, we summarise our initial view (as presented in the consultation document), stakeholders' responses and our decision. Having considered the responses to the consultation and the notification we received on 23 June 2016 from NGG on the proposed transfer of its gas distribution transportation assets to NewCo, we have decided to grant conditional consent for this transfer. This chapter sets out the rationale for our decision.

## **BMPOLR**

2.5. NGG has an obligation in its gas distribution licence requiring it to act as a BMPOLR across all of Great Britain, as set out in Special Condition (SC) 5A (Provision of Meters) and SC 5B (Provision of Terms). This obligation requires NGG to meet any reasonable request by a relevant Gas Distribution Network (GDN) to provide, install and maintain a traditional domestic gas meter. GDNs can call on NGG's BMPOLR obligation to fulfil their own Meter Provider of Last Resort (MPOLR) obligation. Currently, National Grid Metering Ltd (NGML) provides services to NGG in fulfilling NGG's BMPOLR obligation. NGML is owned by NGG and manages the relationships with suppliers.

2.6. If hive across were to go ahead, our initial view was that the BMPOLR obligation should be retained by NGG, by transferring it into NGG's transmission licence. This view was based on our understanding that this option would involve least change for stakeholders and thereby mitigate the risk of disruption for end consumers. It would, therefore, ensure that the interests of existing and future gas consumers are protected.

2.7. In our consultation we asked stakeholders: *What is your view as to which entity, and therefore licence should hold the BMPOLR obligations and why, in the event that the proposed asset and licence transfer takes place?*

### **Responses to our consultation**

2.8. All seven respondents agreed with our initial view that the BMPOLR obligation should be retained by NGG, by transferring it into NGG's transmission licence. However, one respondent's support was conditional on there being no change in the suppliers' contracts with NGML.

## Our decision / response

2.9. With respondents supporting our initial view, we have decided it is appropriate that the BMPOLR obligation be retained by NGG, through transferring it into NGG's transmission licence. In anticipation of this, alongside our May 2016 consultation document, we also published a statutory consultation on introducing a dormant BMPOLR obligation into the transmission licence<sup>17</sup>. Alongside this decision document we have published today a notice of modification of NGG's transmission licence to include these dormant BMPOLR obligations<sup>18</sup>, following the statutory consultation. In the event of hive across, these modifications provide us with the ability to "switch on" the BMPOLR obligation in the transmission licence, ensuring that this obligation is at all times set out in either the distribution or transmission licence.

2.10. Regarding the contracts between NGML and suppliers; these are bilateral contracts and it would not be appropriate for Ofgem to guarantee that these do not change. However, the terms of these contracts are subject to a framework set out in licence conditions. These licence conditions require that the service must be provided on reasonable terms and specifies the essential elements of those terms.

## Xoserve

2.11. Xoserve provides a range of essential services to support the GB gas industry including billing services, managing the booking of capacity, running the gas settlement systems and managing the change of supplier process. Xoserve was created in 2005 by the gas transporters (GTs) in fulfilment of a licence obligation (SSC A15) to appoint an agency for the common provision of certain services and systems. The range of centralised gas transportation services provided by the agency is defined in the GTs' Uniform Network Code (UNC) and licences.

2.12. Xoserve is jointly owned by the GTs, with equal shareholdings for each of the eight GDNs and the single NTS. Currently, therefore, NGG has a controlling stake (through its four GDNs and transmission network). NGG proposed transferring its four GDN shareholdings in Xoserve to NewCo once the assets and licence of NGG's distribution business transfer (ie at hive across, were this to take place).

2.13. Our initial view was that NewCo should discharge the obligations in relation to the gas distribution business with respect to Xoserve and that there should be minimal impact on the services provided by Xoserve as a result.

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<sup>17</sup> <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposed-new-standard-special-conditions-and-special-conditions-national-grid-gas-plc-s-national-transmission-system-nts-gas-transporter-licence>

<sup>18</sup> <https://www.ofgem.gov.uk/publications-and-updates/modification-national-grid-gas-plc-ngg-national-transmission-system-nts-s-gas-transporter-licence-add-dormant-back-stop-meter-provider-last-resort-obligations>

2.14. In our consultation we asked stakeholders: *Do you have any comments in relation to the Xoserve arrangements as a result of the proposed hive across of National Grid Gas Plc (NGG)'s gas distribution business to NewCo?*

### **Responses to our consultation**

2.15. A majority of respondents thought there would be no change, or minimal change, to services provided by Xoserve as a result of the hive across, and were therefore broadly in agreement. However, two respondents highlighted the need for NGG and / or NewCo to continue to engage constructively both in the Funding, Governance and Organisation (FGO) arrangements<sup>19</sup> and Project Nexus<sup>20</sup>, while another two respondents highlighted the importance of Project Nexus.

2.16. One respondent also noted that commercial agreements need to be implemented between transporters and that these are equally important for the ongoing provision of essential transportation services. In this context, the respondent was seeking further detail on NGG's commitments to ensure a smooth transition and continued delivery of services, and proposed that this should be a condition precedent.

2.17. One respondent stated that the corporate and operational impacts are not clear and sought more reassurance and evidence that services will not be affected. The same respondent noted, for example, that the implications of NGG no longer having a controlling stake in Xoserve were not clear.

2.18. NGG, in its response, stated that "*National Grid and the new gas distribution company will continue to participate in ongoing discussions around the future Xoserve Funding Governance Ownership (FGO) Programme.*"

### **Our decision / response**

2.19. We expect FGO and Project Nexus to be complete by 1 April 2017. NG has indicated that the sale will be completed by around this time. Until the sale is complete National Grid (via NGG and NewCo) needs to continue to commit to these programmes, in accordance with its licence obligations, as it has been doing. The requirement to enter into an agency services agreement is an obligation on all

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<sup>19</sup> We undertook a review of Xoserve's funding, governance and ownership arrangements to ensure that it would be fit for purpose, and provide the required responsiveness and flexibility in the context of future industry changes. In October 2013, after consulting on various options, we decided that a full co-operative governance model should be established for Xoserve. A decision on the modifications needed to establish these new arrangements was then published in April 2016.

<sup>20</sup> The UK Link system, operated by Xoserve for energy settlements, supply point administration and other functions for the GB gas market, is scheduled to be replaced. Project Nexus is the industry programme aiming to ensure that the replacement systems meet the current and anticipated requirements of market participants

relevant GTs. Regardless of any potential hive across or subsequent sale, this obligation remains on all relevant GTs - including NG's NTS business and potential buyer of New Co in the future. It is therefore important that all parties remain engaged in and committed to Xoserve, the FGO programme and Project Nexus.

2.20. In May 2016 consultation we proposed, and have now decided to include, a condition precedent on transfer of assets requiring that we are satisfied as to the arrangements on industry codes, including, without limitation, changes to the Uniform Network Code (UNC), preparation of an Individual Network Code and shippers' framework agreement and NewCo signing the Transporter's Framework Agreement. Chapter 3 provides details of the condition.

2.21. We have concluded that NewCo should discharge the obligations in relation to Xoserve, as with other GDNs, once hive across occurs. Until hive across occurs, we expect NGG to continue as currently. Until the sale occurs, we continue to expect NG to discharge its responsibility towards Xoserve (via NGG and NewCo). However, we also note comments by stakeholders regarding Project Nexus and the ongoing implementation of FGO arrangements. Accordingly, we have decided to seek from NG written assurance of its ongoing commitment to Project Nexus and the FGO Programme, to be procured by NGG, as part of wider assurance required as per the condition in paragraph 3.11 of Chapter 3 that must be met prior to the hive across.

## Joint Office of Gas Transporters

2.22. SSC A12 of the GT licence requires the licensees to have in place joint governance arrangements (JGA). These arrangements relate to the administration and modification of the UNC. SSC A12 requires the licensees to enter into a JGA Agreement (JGAA) to provide for the JGA and that changes are only made to the JGAA with the Authority's consent (or deemed consent).

2.23. Our initial view was that we saw no material change arising in the event of hive across on the JGA nor, therefore, on consumers. In the event that changes to the JGAA are proposed, the licence requires that these are submitted to Ofgem<sup>21</sup>.

2.24. In our consultation we asked stakeholders: *Do you have any comments on the impact of the proposed hive across on the Joint Office arrangements?*

## Responses to our consultation

2.25. Similar to the responses on Xoserve, a majority of respondents was in broad agreement with our initial view that no material change is expected to the JGA as a result of the hive across. However, three respondents highlighted concerns relating

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<sup>21</sup> Under SSC A12, the licensee is not permitted to make any amendment to the JGAA until 90 days after a proposed change has been submitted to us – unless prior to that we have consented to the change, or directed the licensee not to make it.



to the risk that the funding, resources or expertise that NGG currently provides may not be retained. One of these respondents thought that, if this were to happen, it would result in short term degradation in service. Another of these respondents expected NGG to provide appropriate commitments in this area.

2.26. One respondent also questioned who had ownership of the equipment and resources used by the Joint Office, how this might be affected by the sale and the consequential implications on the services provided. The respondent saw this as highlighting flaws in the current arrangements and that provision by a third party would be preferable. In this context, the respondent wanted Ofgem to resolve this as part of the forthcoming review of Code Governance arrangements resulting from the Competition and Markets Authority enquiry.

2.27. NGG, in its response, stated that the *"resourcing of the Joint Office is expected to remain largely unchanged immediately after hive-across."*

### **Our decision / response**

2.28. The consultation responses support our initial view that no material changes are likely to arise as a result of the hive across.

2.29. Similar to Xoserve, the obligation to develop, establish and operate joint governance arrangements is on all relevant GTs. However, we recognise the important role played by certain NGG staff. We have decided to seek from NG written assurance on its ongoing commitment to the Joint Office.

2.30. We note that one respondent considered that the Joint Office arrangements should be considered as part of any reforms following the CMA's findings on code governance under the energy Market Investigation Reference (MIR). The CMA has now published its final report and we (and DECC) are initiating work to implement its remedies, including in relation to code governance. We will consider the implications of the CMA's findings and remedies on the Joint Office arrangements, as well as the arrangements for all the other relevant code administrators and delivery bodies, as our work develops in this area.

### **0800 Gas Emergency Number**

2.31. Currently, NGG's distribution business operates a call receipt and management service for the reporting of gas emergencies on behalf of all GTs. This duty is held by NGG plc, under Regulation 7(1) of the Gas Safety (Management) Regulations 1996 (GS(M)R 1996), as a successor to British Gas plc.

2.32. NGG proposed that, after hive across, the 0800 Gas Emergency service number continue to be provided by the gas distribution business that has the assets, people and contracts to provide it. This would require changes to NGG's Safety Case for its remaining gas transmission business and a new Safety Case for NewCo, both of which would need to be submitted to, and assessed and accepted by HSE. The

Authority's consent is not required for changes to the provision of the 0800 Gas Emergency service number but licensees are required to comply with the relevant licence condition relating to the operation and maintenance of a continuously manned telephone service for emergency services. The Authority can take enforcement action for breaches of the relevant licence obligations, where appropriate.

2.33. In our consultation we asked stakeholders: *Do you have any comments in relation to the provision of the 0800 emergency number in the event that the proposed asset and licence transfers take place?*

### **Responses to our consultation**

2.34. A majority of respondents was in agreement with the gas emergency response service being provided by NewCo after hive across, provided HSE accepts the Safety Cases. However, one respondent, who likened the issue to BMPOLR, thought the safest option would be to keep the obligation on NGG. It thought this would ensure the impartiality of the service regardless of the network served.

2.35. NGG in its response noted that *"Subject to the provision of suitable supporting evidence, National Grid and HSE have agreed that the 0800 duty can effectively remain within the gas distribution company."*

### **Our decision / response**

2.36. As already noted, the Authority's consent is not required for changes to the provision of the 0800 Gas Emergency service number. Rather, it is for NGG to submit its Safety Cases to HSE and for the HSE to decide whether or not to accept them<sup>22</sup>.

2.37. Notwithstanding, we noted the view of the one respondent who thought the obligation should remain with NGG, likening it to BMPOLR. We believe there are practical differences between BMPOLR and the emergency number service. In particular, in the case of the emergency number service, the assets, people, and systems to provide it reside within the gas distribution business. Leaving the duty on NGG transmission would require these to transfer giving rise to risk and additional costs. In contrast, in the case of BMPOLR, NGML provides the service to fulfil the obligation; no transfer of assets, people and systems is required.

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<sup>22</sup> SSC A8 (Emergency Services and Enquiry Service Obligations) of the gas transporter licence requires the licensee to establish (or procure the establishment), operate and maintain a single continually manned telephone service, in co-ordination with all other gas transporters, for emergency services. The Authority can take enforcement action for breaches of the relevant licence obligations, where appropriate. Additionally our consent is needed if individual licensees change how they provide a response to an incident, but this is distinct from the provision of the emergency services number.

2.38. We have decided to have as a condition of the hive across that HSE has accepted the Safety Cases (details of this consent condition are presented in chapter 3 and the Appendix). We are in contact with HSE regarding this issue, and will remain in contact with it.

## **Legal entity separation and compliance officer**

2.39. Currently, there are conditions in NGG's distribution and transmission licences, not replicated in other GTs' licences, which were introduced as a result of these licences being held in the same legal entity (ie NGG). These conditions are intended to ensure that there would be no discrimination in favour of a related party (ie to prevent NGG transmission from discriminating against the GDNs it sold, in favour of those it retained).

2.40. Our initial view was that there remains merit in retaining the underlying provisions in these conditions, with minor wording changes to ensure they continue to apply to activities not within the same legal entity but nonetheless within a related entity. This was based on our view that the need for protection against undue discrimination in favour of a related party does not evaporate with legal separation if the party remains related after that separation.

2.41. In our consultation we asked stakeholders: *What are your views on the need for compliance requirements (additional to those of other relevant gas transporters) in NGG's gas transmission licence and in NewCo's gas distribution licence in the event that the proposed asset and licence transfers take place?*

## **Responses to our consultation**

2.42. A majority of respondents was in agreement with our initial view that an amended form of the conditions be retained (although one wanted to review the proposed conditions to ensure that they are proportionate).

2.43. Two respondents did not agree with our view. One of these thought that the existing compliance provisions (SSCs A6 and A34) are adequate and that it is not necessary for additional compliance provisions to be placed on either licensee as a result of the proposed sale. The other respondent who did not agree thought proposed new arrangements should put NewCo on an equal footing with other GDNs, and that it did not envisage a need for additional conditions relative to other GDNs.

## **Our decision / response**

2.44. We remain of the view that legal separation does not remove the need for protection against undue discrimination in favour of a related party. Accordingly, we have decided to retain the provisions in NGG's licences, additional to those of other gas transporters, suitably amended. These amended licence conditions will be the subject of a statutory consultation to be published shortly after this decision document.

2.45. We note the response that NewCo should be subject to the same arrangements as other GDNs. We see the merit in consistent conditions across GTs. For the avoidance of doubt, our concern arises where an entity has significant influence over both a gas transmission network and a gas distribution network. If similar circumstances were to arise with another GT, then we would consider whether to introduce the same provisions into the relevant licences. However, we are not, at this stage, proposing to introduce these conditions into all GT licences.

## Other issues

### Responses to our consultation

2.46. In addition to our consultation questions on specific issues, we invited comments on other concerns or issues that stakeholders might have.

2.47. One respondent thought further clarification on the changes to the UNC would be helpful, in due course. It noted that further consideration might be needed to the number of arrangements / agreements that sit under the UNC.

2.48. Another respondent thought a detailed impact assessment was needed that clearly lists the various impacts and contractual changes. We note that the respondent did not say who it is expecting to undertake this impact assessment and directed a similar comment in its response to NGG's own consultation.

### Our decision / response

2.49. NGG has informed us that changes are likely to be required for two broad areas under the UNC, (1) that NGG's network code will, in future, relate only to the NTS and that it will cease to be a DN Operator, and (2) transitional rules to ensure an orderly transfer of rights and obligations.

2.50. These proposed modifications to the UNC will be dealt with in accordance with the established process and, as such, it is a matter for industry, not Ofgem, to consider what specific changes may be required. To date we are aware of two modifications raised by NGG: MOD0582<sup>23</sup>, which is under self-governance, and MOD 0585<sup>24</sup>, which is not under self-governance and will, in due course, be submitted to us for decision. As already noted (para 2.20), we have decided to place a condition on the asset transfer requiring that we are satisfied as to the arrangements relating to industry codes for the transfer to take effect (including but not limited to the UNC, Individual Network Code and shippers framework agreement). We provide details of the condition in chapter 3.

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<sup>23</sup> <http://www.gasgovernance.co.uk/0582>

<sup>24</sup> <http://www.gasgovernance.co.uk/0585>

2.51. Regarding the comment on the need for an impact assessment, the relevant criterion which determines the need for us to conduct an impact assessment under the Utilities Act 2000, is section 5A(2)(b). An impact assessment is required if our proposal's "*implementation would be likely to ... have a significant impact on*" shippers or suppliers. Our proposals relate to the transfer of assets and obligation to NewCo, without any substantive change to those assets and obligations. As a result of our proposals, there will be a different corporate entity engaged in the related activities but it is open to NGG to maintain the same operational arrangements and reassign the contractual terms to NewCo. In this context, we believe it reasonable to consider that the proposed changes represent a technical change to the contractual arrangements, rather than a substantive change of the arrangements.

## **Decision under SSC A27 in relation to transfer of assets**

2.52. On 23 June 2016, we received from NGG a notice requesting permission to transfer its gas distribution transportation assets from NGG to National Grid Gas Distribution Limited (NewCo) under SSC A27 of the distribution licence.

### **Approach to determining whether or not to grant consent**

2.53. In determining whether to grant our consent under SSC A27 of the gas transporter licence, we have to give regard to our principal objective, our statutory objectives and duties under the Act, as well as our general public law duties. In deciding whether to grant consent outright, conditionally, or to refuse consent, we have to make a proportionate decision that is best calculated to protect the interests of existing and future consumers in relation to gas conveyed through pipes (see our principal objective in section 4AA of the Act).

2.54. In general, we consider transfers between two co-owned licensees as low risk. Notwithstanding this, within this context, in making a decision on whether to consent to the proposed transportation asset and licence transfer we need to ensure that:

- relevant obligations are set out either in the gas distribution licence or in the transmission licence at all times;
- we address any stakeholder concerns around how obligations could be allocated between the transferred (distribution) licence and the retained (transmission) licence;
- the proposed allocation of assets between the transmission and the distribution licensees allows us to maintain the integrity of our price controls; and
- the relative interests of the transmission and GDN consumers are fully protected.

### **Our decision**

2.55. In anticipation of receiving this notice, and to seek early views from stakeholders, we had issued a consultation in May 2016. We have been also working with NGG to understand, among other matters, the basis of its proposed allocation of assets, services and obligations between transmission and distribution licensees in the event of a disposal of the gas distribution transportation assets.

2.56. Having reviewed the responses to our consultation, we have decided to give conditional consent to the transfer of distribution transportation assets from NGG to NewCo. This would facilitate the sale process. This decision does not fetter our discretion when considering whether to approve the proposed transfer of the gas distribution licence. The conditions we are imposing on the transfer of the assets are explained in Chapter 3.

2.57. We see merit in not obstructing, and where possible facilitating, corporate transactions as these may be to the benefit of consumers. In this case some issues have been identified by stakeholders, and we have identified some ourselves, which we consider merit conditions being attached to our consent. However, no significant impact on consumers has been identified which would merit us not consenting to NGG's request. Furthermore, there are potential benefits from legal separation – through more ready comparison of the costs and performance of network companies. Our consultation document included proposed conditions of the consent. Stakeholder comments on these are summarised in chapter 3 and our final conditions detailed in our consent direction (in the Appendix). We will continue to work with NGG on the potential hive across. As part of this we will continue to ensure that we maintain the integrity of the price controls and that there is a fair treatment of the respective consumers.

## 3. Decision on conditions for consent

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### Chapter Summary

This chapter summarises stakeholders' responses on the proposed conditions for consent to the transfer of assets and sets out our decisions on the conditions for consent.

3.1. As noted above in Chapter 1, the Authority has the power to grant consent for the transfer of transportation assets and to impose conditions subject to which this consent could be given in accordance with the terms of Standard Special Condition (SSC) A27 of the gas transporter licence. Any such conditions would need to further the Authority's principal objective under the Gas Act 1986 (the Act) and its statutory duties<sup>25</sup>.

3.2. In our May 2016 consultation document, we proposed various conditions that we anticipated might be in the interests of consumers to impose on National Grid Gas (NGG) were we to give the consent to the proposed transfer of assets. The proposed conditions on NGG, subject to which consent could be given, were in two broad categories: conditions precedent, which must be satisfied before the proposed hive across can occur; and conditions subsequent, which must be satisfied after hive across occurs but before the proposed majority sale of shares in a new subsidiary company (NewCo) can occur.

3.3. In our consultation document, we posed the question: "*Do you have any comments on the Authority's proposed conditions for the asset transfer, or any other conditions you would like to raise?*" Of the seven stakeholders that responded, a majority either agreed with our proposed conditions or had no comment on them. We received one comment on our proposed conditions and a suggestion for an additional condition.

3.4. As noted in Chapter 2, we have decided to grant conditional consent to the transfer of distribution assets to from NGG to NewCo. This chapter sets out the conditions of consent and these are described below and included in our consent directions in the Appendix.

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<sup>25</sup> Under s.8AA of the Act, National Grid Gas (NGG) must seek our consent to transfer their gas distribution gas transporter licence to NewCo. Any decision we make on consent to the transfer of assets does not fetter our discretion when deciding whether to consent to the transfer of the licence.

## Conditions precedent

### **Condition in relation to Secretary of State (SoS) for Energy and Climate Change's power to veto asset transfer**

3.5. Where the transportation asset comprises a significant part of the gas conveyance system in Great Britain, the licensee must provide the SoS with 60 days' notice of its proposed transfer. The SoS has 30 days within which to decide whether to veto the proposal (see SSC A27.11 of the gas transporter licence).

3.6. We have decided to include, as a condition precedent, that the SoS has not vetoed the asset transfer.

### **Health and Safety Executive (HSE) approval of safety cases**

3.7. A gas conveyor cannot operate in the United Kingdom without a safety case accepted by HSE. We have decided to include as a condition precedent that HSE has accepted the operational safety case for both NewCo and NGG.

### **Proposed transfer of the distribution licence**

3.8. To ensure that NewCo would have the right to operate the distribution network legally, the company would have to concurrently obtain a gas distribution licence when it would receive the assets. This licence would be obtained through a transfer of the distribution licence currently held by NGG to NewCo under section 8AA of the Act.

3.9. Section 8AA of the Act requires that the Authority consents to the transfer of the licence. The SoS has the power to direct the Authority not to impose a modification condition under section 8AA of the Act and her prior written consent to the licence transfer is also required under SSC A45 of the gas transporter licence. A condition of our consent is that NGG has obtained consent both from the Authority and the SoS in relation to the transfer of the distribution licence prior to hive across taking place.

### **Hive across of the gas distribution business not to occur before a date nominated by the Authority**

3.10. We will require that hive across cannot occur before 1 October 2016. This is to ensure a smooth transition from NGG to the wholly owned subsidiary on the same day nominated in any section 8AA consent under the Act.



### **Allocation of assets, services and obligations**

3.11. As regulated companies, each regulated company will be allocated funding to finance its activities, of which a proportion will be funded through customer bills. As the independent regulator, we will require assurance from NGG that the proposed allocation of non-transportation assets, obligations and associated operational changes will remain consistent with existing price control arrangements and ongoing commitments. For example, the allocation of legacy obligations such as pension schemes will need to be appropriately split between the two businesses.

### **Uniform Network Code (UNC) changes and other industry agreements**

3.12. In our consultation document, we noted that changes would be required to the UNC and that NewCo would need to prepare an Individual Network Code (INC) and shipper framework agreement. Accordingly we proposed a condition of consent, requiring NGG to satisfy the Authority that the necessary changes to the UNC have been proposed and the modification process is completed prior to hive across, that NGG has prepared an INC for NewCo, and that the relevant shippers have signed the new shipper framework agreement prior to hive across.

3.13. One respondent (as already noted and responded to in Chapter 2), proposed that a condition(s) precedent be introduced in relation to Xoserve and the Joint Office. We have decided to include a condition precedent that the Authority is satisfied as to the arrangements for industry codes and other agreements, including without limitation that:

- the necessary changes have been proposed and made to the UNC;
- an Individual Network Code (INC) has been prepared for NewCo;
- NGG has used reasonable endeavours to ensure that the relevant shippers have signed the new shipper framework agreement;
- that NewCo has signed the Transporters' Framework Agreement;
- that NewCo has signed the agency services agreement (ASA) – in relation to Xoserve; and
- that NewCo has signed the joint governance arrangements agreement – in relation to the Joint Office (JGAA).

### **Other consents**

3.14. NGG has identified a number of other consents, derogations, directions and determinations (apart from the consent to disposal of assets and licence transfer) that may be required as a part of the sales process. A number of these consents relate to the financial transactions and restructuring that would be required to give effect to the proposed sale.

3.15. The Authority will separately consider each of the requests for consent, directions, determinations and derogations. In deciding whether or not to grant these consents, the Authority will make decisions so far as to further its principal objective

and have regard to its statutory duties. We have decided to include as a condition precedent that the appropriate consents are in place prior to hive across.

### **Evidence of conditions being met**

3.16. It will be NGG's responsibility to submit to the Authority evidence that the conditions precedent to consent to transfer the transportation assets have been met. We would require NGG to submit this evidence in writing no less than 7 days before its nominated hive across date. The Authority will then make a decision on whether the evidence submitted meets the requirements stated in the decision document.

### **Conditions subsequent**

#### **Other regulatory, commercial or operational changes**

3.17. We had proposed as a condition subsequent that "*NGG shall consent to any licence modifications and implement any other regulatory, commercial or operational changes following hive down that the Authority considers are necessary in order to ensure that the interests of customers are protected.*"

3.18. One respondent commented that any changes referred to in this condition should arise directly from the hive across and not be used by Ofgem to make changes unrelated to the hive across.

3.19. Our intent was that any changes required under this condition be related to the hive across, rather than providing us with the ability to make other, unrelated changes. Accordingly we have decided to change the condition subsequent to reflect this. We also consider that the conditions subsequent should apply to NGG, who would be responsible for procuring implementation of the condition if necessary through NG and/or NewCo. The final condition in the consent direction in the Appendix is as follows:

NGG shall implement, or use all reasonable endeavours to procure the implementation of, any other regulatory, commercial or operational changes following hive across that the Authority considers are necessary in order to ensure that the interests of consumers are protected with regard to the Proposed Disposal<sup>26</sup>.

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<sup>26</sup> The Proposed Disposal, as defined in our consents direction in the Appendix, is of the gas distribution assets being transferred under SSC A27, including land that has been purchased compulsorily.

### **Material change to information**

3.20. We will require NG to notify the Authority immediately if it becomes aware of any material change to information on the basis of which consent was granted.

### **Maintenance of conditions precedent**

3.21. We have decided to introduce a condition subsequent to require NG, having met a condition precedent, to take no action which would result in the condition not being satisfied.

### **Other stakeholder comments**

#### **Loss of comparators**

3.22. In response to our consultation question on conditions precedent and subsequent, one stakeholder noted our comment that the sale could lead to a loss of comparators and said that more detail on this would be useful to understand whether or not this is a valid concern for consumers.

3.23. Our position is described in para 1.9 and set out in our merger policy letter of May 2010. In brief, a merger can impact on our ability to protect consumers' interests. Some of the reasons for this are described in the Appendix to our merger policy letter. However, our formal role in the sale process (stage 2) is limited. In particular, we have no power to intervene on mergers. Accordingly, we have decided not to change any previously proposed consent conditions nor add any new condition in relation to the potential for a loss of comparators. If we believe the sale may have a potential detrimental impact on our ability to regulate effectively we would advise Government and the merger authorities, consistent with our merger policy.

## 4. Proposed licence changes

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### Chapter Summary

This chapter summarises the stakeholder responses we received to the proposed licence changes and our next steps on it.

- 4.1. As described in Chapter 1, our role in stage 1 (hive across) of the proposed sale includes considering whether to consent to transfer the distribution licence from National Grid Gas plc (NGG) to National Grid (NG)'s new subsidiary (NewCo) (under section 8AA(1) of the Gas Act 1986 (the Act)). This consent can be given subject to modification being made to the distribution licence (section 8AA(4) of the Act). The Act requires the Authority to consult for a minimum of two months on the proposed transfer and modification of the distribution licence.
- 4.2. Should the Authority consent to the transfer and modification of the distribution licence, the Authority would also consult on whether any consequential changes would need to be made to NGG's National Transmission System (NTS) gas transporter licence (under section 23(2) of the Act).
- 4.3. To give industry early sight of potential licence changes, we consulted on these in May 2016, in anticipation of receiving NGG's request for our consent to transfer its gas distribution licence. In our consultation we described a number of proposed licence amendments, that would be required to put into effect some of the arrangements described therein. These also included some other minor amendments, eg to correct outdated references.
- 4.4. We received no substantive comments on the proposed licence condition changes.
- 4.5. On 23 June 2016 NGG submitted to Ofgem a notice requesting consent to transfer its gas distribution licence from NGG to NewCo. Having received this notice, and informed by consultation responses, we have decided to proceed to the next stage and issue a statutory consultations on proposed changes to NGG's gas transmission licence (under section 23 of the Act) and NGG's gas distribution licence (under section 8AA(4) of the Act). We expect to publish these consultations shortly after publication of this decision document.

## 5. Next steps

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### Chapter Summary

This chapter provides a description of the next steps.

5.1. The next steps that we would take are:

- Publication of two, two-month statutory consultations, in parallel, shortly after publication of this decision document, on the proposed:
  - transfer of National Grid Gas' (NGG) gas distribution licence to a new subsidiary (NewCo) and the modification of the gas distribution licence under section 8AA of the Gas Act 1986 (the Act); and
  - consequential modifications to NGG's gas transmission licence under section 23 of the Act.
- Subject to the outcome of the above statutory consultations, the Authority would make a decision on whether to:
  - consent to the proposed transfer and modification of the gas distribution licence;
  - make the proposed gas transmission licence modifications; and
  - issue a direction activating the BMPOLR switch<sup>27</sup>.

5.2. Subject to the outcomes of the consultations and decisions above and NGG meeting the conditions set by the Authority in relation to the transfer of the distribution transportation assets in accordance with the terms of Standard Special Condition A27 of the gas transporter licence, NGG would hive across its gas distribution business to NewCo.

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<sup>27</sup> <https://www.ofgem.gov.uk/publications-and-updates/modification-national-grid-gas-plc-ngg-national-transmission-system-nts-s-gas-transporter-licence-add-dormant-back-stop-meter-provider-last-resort-obligations>

## Appendix – The Authority's consent directions

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### **DIRECTION ISSUED PURSUANT TO STANDARD SPECIAL CONDITION A27 (DISPOSAL OF ASSETS AND RESTRICTIONS ON CHARGES OVER RECEIVABLES) OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE (DISTRIBUTION NETWORK) AND PURSUANT TO PARAGRAPH 3 OF SCHEDULE 3 TO THE GAS ACT 1986**

1. This Direction is issued by the Gas and Electricity Markets Authority (the Authority) in connection with National Grid Gas plc (NGG)'s proposed disposal of certain transportation assets and certain land that has been purchased compulsorily to its affiliate company, National Grid Gas Distribution Limited (NGGDL).

#### **Background**

2. NGG (registered in England with company number 2006000 and whose registered office is at 1-3 Strand, London WC2N 5EH) is the holder of two gas transporter licences, one for its gas Distribution Network business (NGG(DN)) and one for its gas National Transmission System business (NGG(NTS)) granted or treated as granted under section 7 of the Gas Act 1986 (the Act).
3. On 10 November 2015, NGG announced its intention to sell a majority stake in NGG(DN) (the Proposed Transaction).
4. As part of the Proposed Transaction, NGG is seeking to "hive across" its NGG(DN) assets and to transfer its gas transporter licence in respect of NGG(DN) (the Distribution Licence) to NGGDL (registered in England with number 10080864 and whose registered office is at 1-3 Strand, London, WC2N 5EH).
5. NGG is seeking to dispose of NGG(DN)'s assets to NGGDL and has given the Authority notice on 23 June 2016 under Standard Special Condition (SSC) A27 of the Distribution Licence. NGG has proposed the assets (the Transportation Assets) it is seeking to transfer, these assets are defined in annex 1 of this direction. This disposal of assets will require, inter alia, the consent of (alternatively failure to object by) the Authority and that the Secretary of State does not direct the licensee not to proceed with the disposal. The Authority's consent can be given subject to such conditions as the Authority may specify.
6. In addition, NGG is proposing to transfer the Distribution Licence to NGGDL and is seeking the Authority's consent under section 8AA of the Act. The Authority will consult on whether the transfer should be made and, if such transfer is permitted, whether the Distribution Licence should be modified, pursuant to section 8AA(4) of the Act, as part of any consent to transfer the Distribution Licence. The Authority will also consult on whether consequential changes should be made to NGG(NTS)'s licence, pursuant to section 23 of the Act.

7. Accordingly, it is proposed that, at the same time as NGG disposes of the Transportation Assets to NGGDL, NGG will also transfer the Distribution Licence to NGGDL, provided that it has received:
  - a) The consent of the Authority under section 8AA of the Act; and
  - b) The consent of the Secretary of State under SSC A45 (Assignment of Licence) of the Distribution Licence.
8. After hive across, National Grid proposes to sell a majority stake in NGGDL to a third party.

### **Request for consent**

9. In light of the above proposals, NGG requested from the Authority in the Application the following consents:
  - a) Consent under Standard Special Condition (SSC) A27 (Disposal of Assets and restrictions on charges over Receivables) of the Distribution Licence to permit NGG to dispose of and relinquish operational control over the Transportation Assets to its affiliate company, NGGDL;
    - NGG asked the Authority to regard the Application as notice of, and request for consent to, NGG's proposed disposal of, and relinquishing of operational control over, the Transportation Assets to its affiliate company, NGGDL not earlier than 1 October 2016, pursuant to paragraph 4 of SSC A27 of the Distribution Licence.
    - SSC A27 of the Distribution Licence permits the proposed disposal to take place if the Authority does not inform NGG in writing of any objection to NGG's disposal notice within 2 months. NGG 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 NGG to dispose of such land as it has purchased compulsorily which falls within the assets of NGG(DN) to its affiliate company, NGGDL.
10. The proposed Transportation Assets disposal and the proposed land disposal are together referred to as the "Proposed Disposal".

### **Consent**

11. Having carefully considered NGG's consent notice, stakeholders' responses to our consultation and having had regard to its principal objective and statutory and other duties, pursuant to paragraph 10(a) of SSC A27 and paragraph 3 of Schedule 3 to the Act, the Authority hereby directs that, subject to the conditions set out in this Direction, NGG may undertake the Proposed Disposal not earlier than 1 October 2016.

12. 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.
13. Having carefully considered NGG's consent notice, stakeholders' views and having had regard 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 with limitation necessary to ensure that the interests of existing and future consumers are protected.

***Conditions precedent***

14. 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) The Secretary of State has not directed NGG pursuant to SSC A27 not to proceed with the disposal of, or the relinquishment of operational control over, the Transportation Assets;
  - b) The Health and Safety Executive has received safety cases in respect of each of NGG(NTS) and NGGDL and accepted each of those safety cases pursuant to the Gas Safety (Management) Regulations 1996;
  - c) The Secretary of State has consented in writing to the transfer of NGG(DN)'s Distribution Licence to NGGDL pursuant to SSC A45 (Assignment of Licence);
  - d) The Authority has consented (pursuant to section 8AA of the Act) in writing to the transfer of NGG(DN)'s Distribution Licence to NGGDL in accordance with the Authority's consent;
  - e) In the reasonable opinion of the Authority, in light of information submitted by NGG, the allocation of non-transportation assets, obligations and associated operational changes will remain consistent with existing price control arrangements and ongoing commitments;
  - f) In the reasonable opinion of the Authority appropriate arrangements relating to industry codes and other industry agreements, including without limitation the Uniform Network Code, have been made, an Individual Network Code has been prepared for NGGDL, NGG has taken all reasonable endeavours to ensure that the relevant shippers have signed the new shipper framework agreement, and NGGDL has signed the Transporters' Framework Agreement, the agency services agreement (ASA), and the Joint Governance Arrangements Agreement (JGAA); and
  - g) Any other consent, clearance, permission, authorisation or approval required under statute, the Distribution Licence or otherwise in respect of the proposed hive across of NGG's Transportation Assets to NGGDL is obtained.



15. NGG must submit in writing to the Authority no less than 7 days before its nominated hive across date evidence that the conditions precedent in paragraph 14 above have been met. Informed, in part, by this evidence, if any of the conditions set out in paragraph 14 above are not satisfied in full by 1 October 2016 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; and/or
  - c) Vary or otherwise modify any unsatisfied condition or conditions.

***Conditions subsequent***

16. In addition to the conditions in paragraph 14, the consent of the Authority set out in this Direction is in all respects conditional upon the following:
- a) NGG shall implement, or use all reasonable endeavours to procure the implementation of, any other regulatory, commercial or operational changes following hive across that the Authority considers are necessary in order to ensure that the interests of customers are protected with regard to the Proposed Disposal<sup>28</sup>.
  - b) NGG shall ensure that where any condition has been satisfied, it shall take no action which would result in such condition no longer being satisfied.
17. NGG 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 Disposal or any change in relation to any of the conditions to consent contained in this Direction.
18. The consent given by this Direction applies only for the purpose of the said SSC A27 of the Distribution Licence and paragraph 3 of Schedule 3 to the Act and shall not apply or be deemed to apply for any other purpose.

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<sup>28</sup> The Proposed Disposal, as defined in our consents direction in the Appendix, is of the gas distribution assets being transferred under SSC A27, including land that has been purchased compulsorily.

## ANNEX 1

19. This section contains extracts from NGG's request for asset transfer under Standard Special Condition A27 of the distribution licence. These extracts define the assets that will be transferred.

### Appendix 1

**This Appendix sets out the definitions of certain terms used in the letter of 22 June 2016 from National Grid Gas plc to Ofgem requesting consent:**

- (1) under Standard Special Condition A27 of the Distribution Licence for the disposal of the Transportation Assets (as defined in the letter); and**
- (2) the disposal of land which has been compulsorily purchased under Schedule 3 of the Gas Act 1986.**

**"Distribution Networks"** means the distribution networks of East of England, London, North West and West Midlands each of which are defined in Standard Special Condition A3 (Definitions) of the Distribution Licence.

**"Assets"** means the facilities used for the diurnal storage of gas within the Distribution Networks and the pipeline system operated by NGG plc from each NTS/LDZ Offtake or other point at which gas is input to the Assets (as referred to in Schedule 2) 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 Uniform Network Code) from that pipeline system within the Distribution Networks together with all apparatus ancillary thereto including those Assets outside the Distribution Networks referred to in Schedule 3.

**"NTS/LDZ Offtake"** means a point at which gas flows out of the NTS and enters the Assets and which is referred to in Schedule 1.

**"NTS"** means the national transmission system as defined in the Uniform Network Code.

**"Uniform Network Code"** means the document prepared by NGG and other relevant gas transporters pursuant to Standard Special Condition A11 of the Distribution Licence.

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**Schedule 1**

<b>DN</b>	<b>NTS/LDZ Offtake</b>
	Bacton
	Brisley
	Peterborough (Eye) Tee
	West Winch
	Great Wilbraham
	Roudham Heath
	Yalverton
EofE	Matching Green
	Royston
	Whitwell
	Thornton Curtis
	Walesby
	Blyborough
	Gosberton
	Kirkstead
	Silk Willoughby
	Sutton Bridge
	Alrewas EM
	Blaby
	Drointon
	Tur Langton
	Caldecott
	Market Harborough
	Steppingley
NL	Winkfield NT
	Horndon
	Luxborough Lane
	Peters Green
NW	Peters Green South Mimms
	Blackrod
	Lupton
	Samlesbury
	Audley NW
	Ecclestone
	Holmes Chapel
	Malpas
	Mickle Trafford
	Partington
Warburton	
WM	Weston Point
	Aspley
	Audley WM
	Milwich
	Alrewas WM
	Austrey
	Shustoke
	Leamington Spa
	Lower Quinton
	Ross on Wye WM
	Rugby
Stratford upon Avon	

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**Schedule 2**

DN	Site	Type	Status
E of E	Adnams	Biomethane	Live
	Chittering	Biomethane	Live
	Euston Estates (Lankets Grove)	Biomethane	Live
	Fairfields farm	Biomethane	Live
	Holkham	Biomethane	Live
	Mepal	Biomethane	Live
	Methwold	Biomethane	Live
	Raynham	Biomethane	Live
	Sotterley	Biomethane	Live
	Bay Farm	Biomethane	Under construction (live prior to hive across)
	The Oaks	Biomethane	Under construction (live prior to hive across)
	Westry	Biomethane	Under construction (live post hive across)
	Hibaldstow	Biomethane	Live
	Manor Farm	Biomethane	Live
	Metheringham	Biomethane	Live
	North Moor Farm	Biomethane	Live
	Scampton	Biomethane	Live
	Welbeck Colliery	Biomethane	Live
Lindholme	Biomethane	Live	
Derby	Biomethane	Under construction (live prior to hive across)	
Stoke Bardolph			
NW	Bredbury	Biomethane	Live
	Davyhulme	Biomethane	Live
	Widnes	Biomethane	Live
	Holford	Salt Cavity	Live
WM	Brinklow	Biomethane	Live
	Hampton Bishop	Biomethane	Live
	Minworth	Biomethane	Live
	Grindley House Farm	Biomethane	Under construction (live prior to hive across)
	Roundhill	Biomethane	Under construction (live prior to hive across)
Strongford	Biomethane	Under construction (live prior to hive across)	

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### Schedule 3

DN	LDZ Offtake	Type
E of E	Cranfield	AGI/PRS
	Deanshanger	Pipeline Crossing
	Catshaw (Greenfield Pipeline)	AGI/PRS
NL	Ascot Terminal	AGI/PRS
	Bracknell Station	AGI/PRS
	Dolesden	AGI/PRS
	Dryburgh Lane	Governor
	Dunstall Green	AGI/PRS
	Fairview Drive	Pipeline Crossing
	Martyrs Lane	Governor
	Oak Avenue	Governor
	Richmond	Valve
	Roehampton Lane	Governor
	Wandsworth	Valve
NW	Drome Corner	Pipeline Crossing