

Single Electricity Market

Acquisition of NIE plc, NIE Powerteam and allied businesses by ESBNI Ltd

14th March 2011

SEM/11/011

Introduction

1. In July 2010, Electricity Supply Board and ESBNI Limited (**ESB**) entered into a sale and purchase agreement with Viridian Capital Limited and Viridian Group Limited (**Viridian**) for the sale and purchase of Northern Ireland Electricity plc (**NIE**); NIE Powerteam Limited and Powerteam Electrical Services (UK) Limited (PES) and Capital Pensions Management Limited, (**the Purchase**). As ESB completed the Purchase in December 2010, ESB now own NIE. Further details of the Purchase are set out at paragraphs 9-12 below.
2. The SEM Committee (**the SEMC**)¹ has considered the regulatory functions that might be exercised in relation to the Purchase, and determined that the impact of the Purchase has or is likely to have a material effect on the Single Electricity Market (**SEM**). Therefore it is necessary to review the transmission licences of NIE and ESB and documents generated under those transmission licences (**Licences**) in light of the Purchase as it is a SEM matter. The SEMC has subsequently reviewed the Licences in order to ensure that they remain appropriate in light of the Purchase. This consultation paper sets out those changes that the SEMC considers are required to the Licences or to other documents or information required under those Licences (**the Licence Changes**). The suggested Licence Changes relate only to the NIE Licence.
3. Having reviewed the Licences, the SEMC is of the view that the existing licensing structure is robust and already deals satisfactorily with a lot of the issues the Purchase would otherwise have created and which initially concerned the SEMC. This is because, when the Internal Market in Electricity Second Directive² was implemented, it mandated the imposition of a regime of ring fencing and independence on vertically integrated businesses such as NIE and ESB. This implementation means that there is already a significant degree of protection of the sort that would otherwise have been sought to ensure the Licences remained fit for purpose. So, for example, the Viridian interests in networks, generation and supply were all formally ring fenced from each other and where relevant that was already reflected in, for example, the NIE licence. The existing high level of protection is further evidenced by the fact that both constituent competition authorities have cleared the Purchase. However, the SEMC is also of the view that because a trade purchaser has made the Purchase (as opposed to a financial institution which Arcapita, the former owner was) allied to the unique all Island Single Electricity Market where ESB already have significant market power, there is a need to make some Licence alterations in light of the Purchase. It should be noted that other SEMC work streams on the SEM are not part of this consultation nor is this consultation addressing the implementation of the Internal Market in Electricity Third Directive³, nor is it dealing with ongoing jurisdiction specific analysis of the impact of the Purchase that is not directly related to the SEM. This consultation is solely in relation to what is set out in paragraph 2 above.
4. The SEMC has therefore, in line with the principles of good regulation, sought to suggest only Licence Changes that it considers will deal with remaining concerns about the Purchase as they could materially impact on the SEM and also reflect the new ownership structure that is in place after the Purchase. It is not the SEMC's role to over regulate and in dealing with the concerns listed in paragraph 5 below, this should be balanced against advantages of the Purchase, such as joint working where storms impact on one of the networks and the achievement of other appropriate synergies.

¹ There is a single all island electricity trading market (the Single Electricity Market or **SEM** for short). The SEMC decides on matters where the exercise of a relevant function by a regulatory authority in either Northern Ireland or Ireland (being the Northern Ireland Authority for Utility Regulation (the **Utility Regulator**) in Northern Ireland and the Commission for Electricity Regulation (**CER**) in Ireland) relates to a SEM matter. The legislation setting this out is The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007, Article 6 and The Electricity Regulation Act 1999, Section 8.

² Directive 2003/54/EC

³ Directive 2009/72/EC

5. Those remaining concerns relate to the impact of the Purchase on the organisational structure of ESB and NIE and also to the level of influence of ESB within the electricity sector on the whole Island and specifically:
 - a. That ESB's role in the energy market on the Island will increase as a consequence of the Purchase. Specifically, that ESB or an affiliate of ESB will have an impact in most areas of the electricity market, including supply, generation and network ownership. The SEMC therefore propose Licence Changes that focus on drawing out more information from NIE and ESB. This should, in turn, lead to greater transparency on how both entities operate. This will address concerns raised by the market on this increase in the significance of ESB. In turn, this should help maintain confidence in the all Island electricity market.
 - b. That ESB is a trade buyer of NIE. In other words, ESB and NIE operate in the same industry. This is different from the previous ownership structure of NIE, as NIE was owned by a financial institution. The SEMC is therefore keen to address the risk that ESB could, over time, make decisions or start to operate in a way that will impact on the operational independence of NIE or which reduces the effectiveness and efficiency of NIE. SEMC has therefore taken a fresh look at the business separation and independence provisions of the Licences and is proposing changes that, in light of the Purchase, reflect the reality of that new environment.
6. Consultees should note that the SEMC only has vires to consider Licence Changes. However, the SEMC is aware that ESB has given assurances to the Department of Enterprise, Trade and Investment (**DETI**) on how both NIE and ESB will operate. The Minister at DETI and the Minister at the Department of Communication, Energy and Natural Resources (**DCENR**) have also been in dialogue and the Minister has received assurances from her counterpart in relation to the Purchase (which together with the ESB to DETI assurances, are in this paper described as the **Commercial Measures**). Although this consultation is on the Licence Changes and not the Commercial Measures, the SEMC in considering Licence Changes has been mindful of the Commercial Measures as that should also assist in addressing concerns raised by the market on the increase in the significance of ESB.
7. Paragraphs 13-15 sets out the Commercial Measures in more detail.
8. Conditional upon the outcome of this consultation, the SEMC is minded to take the view that the proposed Licence Changes, in the context of the Commercial Measures, will be sufficient to satisfy the issues set out in paragraph 5 above. However, the SEMC is mindful that any consultation is done in a snap shot of time and the issues that materially impact the SEM and the relevant functions of the regulatory authorities can alter over time as will the impact of issues such as the implementation of the Internal Market in Electricity Third Directive. The SEMC will therefore continue to keep under review the arrangements for NIE and ESB and will continue to review how appropriate both Licences remain in response to changing circumstances. The SEMC also wish to emphasise that any issues on the Purchase not related to paragraph 2 above can be pursued in parallel or subsequently by the relevant jurisdictional regulator.

Background

9. ESB and Viridian announced the Purchase on 7 July 2010 and completed the Purchase on 21st December 2010. The Purchase was conditional on UK and Irish merger control clearances, both of which have happened. The Purchase is of the company which owns the electricity transmission and distribution infrastructure in Northern Ireland. There is an allied

purchase of NIE Powerteam Limited and PowerTeam Electrical Services (UK) and Capital Pensions Management Limited all of which, in summary, provide services to NIE`.

10. ESB is a statutory corporation and it is owned effectively by the Government of Ireland. ESB's interests in Ireland can be summarised as follows:
 - a. Ownership of networks, through ESB Networks;
 - b. Supply of energy, through ESB Energy Solutions; and
 - c. Generation of electricity, through ESB Energy International.
11. ESB is therefore involved in the full energy supply chain. It should, however, be noted that the operation of the networks/transmission assets both in Northern Ireland and Ireland is the responsibility of SONI and EirGrid.
12. Viridian is owned by Electric Invest Acquisitions Limited, a company owned by Arcapita Bank B.S.C.(c). Viridian's interests prior to the Purchase could be summarised as follows:
 - a. Ownership of networks, through NIE (the subject of the Purchase);
 - b. Supply of energy, through NIE Energy (regulated) and Viridian Power & Energy (unregulated);
 - c. Generation of electricity, through Viridian Power & Energy; and
 - d. Electrical contracting services, both to regulated entities like NIE and unregulated businesses.
13. The SEMC also set out, by way of context setting only (and not for consultation) the detailed Commercial Measures (where they are not embodied in the Licence Changes). ESB has offered to:
 - a. continue to operate its generation and supply interests in Northern Ireland separately from NIE;
 - b. continue to operate NIE independently in the interests of Northern Ireland consumers and market participants;
 - c. change its internal corporate documents (e.g. its Code of Conduct for members of the ESB Board) to ensure that part of its overall corporate responsibility of those Directors is to have due regard to the interests of consumers of electricity in both Ireland and Northern Ireland;
 - d. ensure the composition of the ESB Group Board reflects the importance of NIE to Northern Ireland and electricity consumers in Northern Ireland;
 - e. retain levels of staff and management at current levels;
 - f. remain committed to the financial strength of NIE so that it can fund both its day to day operational and maintenance responsibilities and also the capital programme which is key to help deliver the DETI Strategic Energy Framework goals for renewable electricity and to continue to ensure that NIE remains creditworthy;
 - g. ensure that profits (subject to repayment obligations) are reinvested in the business;

- h. ensure that ESB networks will not receive favourable treatment in investment over NIE; and
- i. ensure that the visible future requirements like SMART technologies are incorporated into any agreed capital programme.

These measures are also backed by assurances given by the Minister at DCENR who has also written to the Minister at DETI stating that it is the Minister's intention (subject to law and precedent) to ensure satisfactory representation of the Northern Ireland perspective on the ESB Group Board is maintained in the future.

14. The commitments made by ESB and the Minister although they do not influence the Licence Changes, do set a context within which the Licence Changes are proposed. In this regard, the SEMC notes these commitments.

The proposed Licence Changes (NIE Licence)

Condition 3: Availability of Resources and Undertaking of Ultimate Controller/Compliance Plan

- a. Condition 3 requires the Licensee to give a certificate to the Utility Regulator each year that states the Licensee has a reasonable expectation that it has the financial facilities and resources to carry on the business over the next 12 months. As part of that, the Licensee has to give a statement of the main factors which the directors have taken into account in coming to this view. The SEMC wish to see more of the thinking on the main factors that helped to form the basis of the certificate brought forward into the statement given. So, the existing statement would be supplemented with, for example, an annex detailing the information used in coming to the conclusion. This annex of information would be new. This will be an important confidence building measure that will demonstrate in even more detailed terms than it does now, the financial health of the Licensee. Given that the Licensee will necessarily gather evidence to support its view, the SEMC does not see this as adding a regulatory burden. The SEMC is also of the view that this should be effected by a discrete licence change to make clear that the Utility Regulator will expect the statement to be backed not only by the main factors taken into account but an annex of the information used in making the statement.
- b. Condition 3 also requires the Licensee to act in a manner calculated to secure it has sufficient resources to enable it to comply with its obligations and to carry on as a standalone entity. This is a wider ranging obligation than the financial certificate mentioned above. The SEMC wishes to see the existing Compliance Plan (a plan which, in effect, sets out how the Licensee operates independently) specifically address how this Condition is fulfilled each year. This Compliance Plan is publically available and the SEMC are of the view that this information would assist confidence building in the Purchase and how it impacts on the market. Again, given the Licensee will already have this information available, the SEMC do not see this as adding a regulatory burden.
- c. NIE is already subject to public procurement legislation. However, given that after the purchase there is a common owner of regulated and a lot of unregulated transmission assets and support services across the Island, the SEMC wish to see the issue of procurement given more focus in the Licence. The existing ESB licence is helpful in ensuring that assets and services must be procured from the most economic sources available and that any assets or services given by an affiliate must be on an arms

length basis. The SEMC consider this language should be mirrored in the NIE licence as a way of giving more focus and prominence to this issue and to underscore the pre-existing procurement obligations already incumbent on NIE. The SEMC consider that this explicit language will help re-assure market entrants that procurement happens in the right way.

- d. The ultimate controller undertaking to be given by the new owner should be widened to ensure that the ultimate controller does nothing to prejudice the interests of consumers of electricity in Northern Ireland. This will mirror the Commercial Measures where the ESB Code of Conduct alters to make the same point and is therefore a logical step in the Licence to build confidence that a trade buyer on the same island will not prejudice the interests of electricity consumers in Northern Ireland.
- e. The SEMC would also like to see best practice followed, such that Condition 3 makes reference to personnel, fixed and moveable assets, rights, licences, consents and facilities, as set out in the equivalent NGC licence. Adopting the NGC definition does not widen what the Condition aims at, but it does go into more detail and give clarity that in the context of a trade buyer purchasing NIE, NIE does have the right approach to availability of resources. The SEMC think this will be a helpful signal to the market if this was adopted.

In summary, the SEMC consider that the above mechanisms would both help build confidence in competition and give more focus to how NIE operates. Given the unique nature of the Purchaser and the unique energy market in the island of Ireland, the SEMC considers these changes to be necessary. The SEMC also consider that they do not represent an additional unnecessary burden on the Licensee.

15. Con 3A: Board Independence

- a. The SEMC would like to see this condition alter to say that at least one executive director needs also to be independent from the ultimate controller. "Independent" in this context means a director who is employed by the Licensee and who does not and has not in the previous two years held a directorship or had material business dealings with the owner of the Licensee or any affiliate of the Licensee. This will mean that not only will a majority of the board be independent from the new owner (the existing licence condition), but that the day to day directors who run the Licensee also have at least one member who is also independent. The SEMC see this as a useful practical measure to ensure that when any major decisions are taken by the Licensee, the people making the decision are as independent as is appropriate from the parent. Consultees should recognise that this independence will always be subject to the correct and proper rules of corporate governance where ESB will have a legitimate and necessary interest in what NIE does.

16. Con 4: Restrictions on Dividends/Licence tidy up

- a. The SEMC is of the view that a lot of the existing conditions may be better suited in being consolidated. So, for example, if the Directors of NIE have to make a declaration for any reason, those declarations are contained in one licence condition. Another example would be removing SEM Go Live dates which are no longer needed. This is less of a substantive point and more about making the licence easier to operate in practice and thus easier for any market entrant to review the licence and understand what it is doing. This will also reduce the regulatory burden on the Licensee.

17. Con 10: Restriction on Use of Certain Information

- a. The SEMC suggest this condition is altered to be explicit that the only types of information that would be made available between NIE and ESB would be types pre agreed with the Utility Regulator (and if protected information, also in accordance with the existing safeguards). These types of information could be set out in the Compliance Plan. Although the actual information sent would not normally be in the public domain, the types of information would be. The Utility Regulator would maintain the ability to check that the Compliance Plan was being adhered to. The SEMC believes that setting out these types of information flowing from NIE to ESB will assist transparency and would therefore help build confidence in the market about the actual type of information flow between ESB and NIE.

18. Con 12: Independence of the Transmission and Distribution Business

- a. Condition 12 limb (c) effectively already says that when NIE is making decisions around the development of the total system, that must be taken by people who work for NIE and the only influence any owner can have is a normal corporate governance role. That is further caveated that in exercising that corporate governance role, the owner cannot do that in a way that *inter alia* affects competition. The SEMC wish to see limb (c) widened to reflect the concept that any corporate governance role will not prejudice the interests of electricity consumers in Northern Ireland as well as not impacting on competition. This will mirror the Commercial Measures where the ESB Code of Conduct alters to make the same point and is therefore a logical step in the Licence to build confidence that a trade buyer on the same island will not prejudice consumers.
- b. Condition 12 paragraph 3A - as ESB is structured, the currently worded undertaking cannot be given. The SEMC are mindful that corporate structures can alter frequently and therefore are currently of the view that the nature of the undertaking should remain the same, but that who gives that undertaking should be agreed between the Utility Regulator and the licensee from time to time.
- c. The Compliance Plan should be reviewed to reflect the new ownership structure, and SEMC recommend that a new Compliance Plan should be submitted to the Utility Regulator no later than the end of June. The SEMC understand that it has been agreed that this will be done voluntarily between NIE and the Utility Regulator without having to alter the Licence itself.
- d. The definition of Associated Business, around which the independence of the Transmission and Distribution business hinges needs to be altered to include ESB. This is important to reflect the factual ownership position when ESB are the owner.

How to Respond

19. The SEMC welcome representations and views from all interested parties as to the proposed Licence Changes, as to other potential Licence changes or any other relevant points. Responses should be received by 6 May 2011. The SEMC have asked Kevin O'Neill of the Utility Regulator to act as the point of contact and recipients of any representations made. The contact details are set out in paragraph 22 below.

20. It should be noted that any licence modifications to NIE's licence can only be made by the Utility Regulator in accordance with the modification procedures set out in legislation.⁴
21. Unless otherwise advised by respondents, responses may be made publicly available, via the AIP website. Respondents should clearly mark any part of their response they wish to remain confidential. The SEMC will do its best (under law and good practice) to honour this, but respondents need to be aware that the SEMC when responding to the consultation may have to give details of representations made to properly consult. It should be noted also that information provided in response to this consultation, may be subject to publication or disclosure in accordance with the Freedom of Information legislative regimes applicable to each regulator.
22. Contact Details for responses are:

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⁴ See Article 14(1) Electricity (NI) Order 1992 (as amended)