



**Consultation on
Acquisition of NIE, NIE Powerteam and allied
businesses by ESBNI Ltd**

ESB's Response

6th May 2011

Introduction

ESB is pleased to have this opportunity to respond to the SEM Committee's consultation on proposed licence changes to NIE's Transmission and Distribution Licence (the "**Licence**"). We welcome the consultation and in particular the emphasis placed by the SEM Committee in the document on the importance of good corporate governance. ESB has always placed a strong emphasis on effective corporate governance in the running of its existing businesses and we aim to continue this approach for NIE.

NIE has always been a very well managed company that has been dedicated to serving the electricity consumer in Northern Ireland. ESB is anxious to ensure that NIE continues to be a well governed company contributing effectively to economic development and consumer interests in the future.

It is also our understanding that a further consultation will take place regarding the precise language of any proposed modifications to the licence conditions. We welcome this consultation and look forward to participating in the process. Therefore, while ESB has not commented on many of the proposals in the consultation paper, we reserve the right to comment on any proposed wording to implement those proposals.

General Comments

We are pleased that the SEM Committee (SEMC), having considered the impact of ESB's purchase of NIE plc (and other related businesses) on the Single Electricity Market (SEM), has concluded that the existing licensing structure for ESB and NIE is robust. The paper also notes that the existing high level of protection is further evidenced by the clearance of the purchase by both the Office of Fair Trading and the Competition Authority.

ESB agrees that certain amendments to the Licence (and the Compliance Plan) are required to reflect NIE's new ownership structure and this has been the subject of discussions between ESB, NIE and the SEMC. Further, we welcome the SEMC's approach of suggesting only licence changes that it considers necessary. However, as a matter of principle, we do not believe that ESB's position in the SEM, or ESB's position as a trade buyer, should necessitate any more onerous licence restrictions.

NIE's former corporate group, the Viridian Group, also participated in the SEM. ESB believes that any market power that ESB may have is, by definition, mitigated by the inherent features of the SEM rules. Further, ESB's position in the market, in terms of generation, supply and network ownership, is already subject to licence conditions with which ESB is fully compliant. Consequently we have in place the necessary ring-fencing arrangements to support compliance. There will be no change in this approach as a result of the acquisition of NIE.

Notwithstanding the foregoing, ESB has sought to take a pragmatic approach in its response to this SEMC consultation and to limit comments to key concerns.

Specific Comments on Licence Changes

Condition 3

a: Annex of Information to Certificate on Financial Facilities and Resources

If the requirement for a Licence modification is agreed with NIE, then the new Licence wording should make it clear that the required annex would relate only to the key material information underpinning the certificate (to avoid creating an undue burden of disclosure on NIE), namely the systems, equipment, facilities, property, personnel, data and management resources underpinning the requisite financial resources. Further, it is assumed that any such annex would not be made public as it may contain confidential or commercially sensitive information.

b: Inclusion of provision in Compliance Plan on how NIE will comply with Licence requirement

In principle, ESB does not have any strong objection to this proposal, provided that this obligation will not require NIE to include confidential or commercially sensitive information in the Compliance Plan or the Compliance Report. We do not consider that any Licence change should be required to give effect to this proposal as the content of the Compliance Plan requires approval of the Utility Regulator.

d: Extension of Ultimate Controller Undertaking

This amendment seeks to impose obligations on the ultimate controller, which is not the licensed entity. ESB believes that the proposed change would materially alter

the scope of the existing requirements for undertakings which are, in summary, directed at (i) ensuring that the ultimate controller does not do anything to prevent the licensee from discharging its obligations and (ii) ensuring that the holding company exercises its corporate governance role in accordance with the requirements of the Internal Market in Electricity Second Directive¹. As such, ESB is unclear as to the basis for seeking to impose such an additional obligation on the ultimate controller through the Licence.

ESB is of the view that both the terms of the Licence and the legislation governing NIE have as one of their overriding objectives the protection of consumer interests, and ESB as ultimate controller is obliged to refrain from any action which would be likely to cause NIE to breach the legislation. Therefore the obligations apply to ESB indirectly by way of its ultimate controller undertaking, requiring it to refrain from taking any action likely to cause NIE as the licensee to breach any of its Licence obligations. ESB believes that the combination of these existing measures already has the effect contemplated by the proposed Licence change. ESB considers that seeking to impose any further obligation on the ultimate controller through the Licence is not appropriate and, further, should not be necessary.

Condition 3A: Board Independence

Condition 3A of the Licence currently requires that the Board of NIE must have a majority of non-executive directors. It is proposed to continue the structure whereby NIE has three independent non-executive directors and two executive directors. As discussed with the SEMC, the three independent non-executive directors, one of whom will be the Chairman, have already been appointed. This arrangement ensures the necessary oversight of the company's performance.

The SEMC have put forward the concept of an "independent" executive director as a new requirement under the Licence. We do not believe that such a concept is necessary or has merit. The arrangement would be unusual by reference to normal corporate practice, and NIE has no peculiarity of corporate structure or status that would justify introducing such an anomalous arrangement. The existence of a majority of non-executive directors on the Board of a significant subsidiary company is already unusual by reference to Great British or Irish precedent, but as this was the position prior to the acquisition being completed we are happy to continue with the existing arrangements.

¹ Directive 2003/54/EC

All directors of a company have legal and fiduciary obligations to act in the best interests of the company. All contributions to the Board's deliberations are valuable. Executive directors bring operational and deep company experience, whereas non-executive directors bring wider business sense and independent challenge to the decision making process. Nonetheless, the Board endeavours to achieve consensus to arrive at the optimum decision for the company. Therefore, the position of an executive director as an employee of the company is of no consequence.

As long as the majority of Directors of NIE are independent (as such term is defined in the Licence) then it would seem irrelevant whether or not an executive director is independent, as any delegation by the Board of authority to that person in respect of executive decisions/actions will also be subject to Board approval.

We believe that the Utility Regulator already has all the necessary oversight of the company's business through the Licence and that this measure is unduly restrictive and, importantly, would potentially significantly diminish the pool of available expertise available to sit on the Board.

Accordingly, ESB takes the view that the proposed additional requirement is not necessary and, in fact, it would potentially be harmful to NIE to prescribe such a requirement in the Licence.

Condition 10: Restriction on Use of Certain Information

ESB has a concern that this proposed modification would be very difficult to implement in practice.

As we understand it, this would require NIE to agree with the Utility Regulator an exhaustive list of the types of information which may be shared between ESB and NIE. However, the types of information would be difficult to classify or list exhaustively and may be subject to change from time to time. It would place an administrative burden on each of NIE and ESB to have to seek an amendment to this list in order, for example, for ESB to be in a position to exercise its corporate governance role from time to time.

The Licence and Compliance Plan already set out the principles and rules restricting information flows between ESB and NIE. Further, as required by the Licence, ESB has given an undertaking to NIE with regard to protected information which it obtains from NIE. Both ESB and NIE are mindful of these existing requirements and ESB

considers that these existing measures are sufficient to address any concerns with regard to information flows.

It is considered that this proposed condition could hinder efficient conduct of business and is not necessary.

Condition 12: Independence of the Transmission and Distribution Business

a. Condition 12 3(c): Ultimate Controller Undertaking

Please see above our comments in relation to Condition 3(d). As stated, it is considered excessive to include an additional onus on ESB (as holding company) through the Licence in this manner. We would also point out that, as part of the Commercial Measures referred to in the consultation document, ESB has voluntarily amended its directors' code of conduct in line with paragraph 13 c of the consultation document.

Separately, ESB seeks an amendment to Condition 12 3(c) to clarify that persons engaged by NIE on a secondment basis can take decisions relating to the T&D business.

b. Condition 12 paragraph 3A: Relevant Holding Company Undertaking

ESB agrees with the proposal for Condition 12 3A and notes that this will require a change to the definition of "Relevant Holding Company" which currently does not cover ESB. As the SEMC is aware, ESB is anxious to provide the relevant undertaking and is currently acting as if the undertaking is in place.

As has been previously advised by ESB to the Utility Regulator, the unbundling requirements of the Internal Market in Electricity Second Directive do not prevent ESB from exercising a corporate governance role in relation to NIE regardless of whether ESB itself generates or supplies electricity.

Accordingly ESB proposes the following revised definition:

"relevant holding company" means the ultimate holding company of the Licensee acting through a part of its business which does not itself generate or supply electricity on the Island of Ireland.

d. Definition of Associated Business

As drafted, the definition of an Associated Business would include ESB. However, this should be amended to explicitly exclude ESB to ensure that ESB can exercise its corporate governance role and also provide services to NIE. It is understood that licensed generation and supply business units may need to continue to be covered by the definition of "Associated Business".

This should be achieved through the above proposed change to the definition of Relevant Holding Company (as this term is carved out from the definition of Associated Business). However, ESB would welcome the opportunity to further discuss any proposed solution to this issue.

Similarly, ESB considers that ESB Networks should be carved out of the definition of Associated Business. This would allow the two networks businesses to cooperate and maximise synergies within the parameters of applicable laws and the regulatory regime (including, without limitation, the ultimate controller undertakings given by ESB (in respect of ESB and its subsidiaries) and, to the extent applicable, competition law). In this regard, it is worth noting that in granting merger clearance for the acquisition of NIE, both the OFT and the Irish Competition Authority have confirmed that the networks in each jurisdiction are separate markets and are not in competition with each other.

In this regard the following revised definitions are proposed:

"Associated Business" means any business of the Licensee (or of any affiliate or related undertaking of the Licensee) other than a relevant holding company, the Transmission and Distribution Business, the Land Bank Business, ESB Networks, and Powerteam "

"ESB Networks" means ESB Networks Limited and the business unit of ESB known as ESB Networks which holds the Transmission System Owner licence and/or the Distribution System Owner Licence granted by the Commission for Energy Regulation as amended from time to time;"

ESB would be pleased to contribute further regarding the above definitions (and other licence modifications) in the subsequent consultation relating to the precise wording of proposed licence modifications.

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