

The Proposed Company Structure
of Northern Ireland Energy
Holdings Limited
Outcome of the Consultation

Northern Ireland Authority for Energy
Regulation
September 2005

Introduction

The Northern Ireland Authority for Energy Regulation (the Authority) issued a consultation paper on 25 July 2005 seeking responses on issues raised by the proposal to incorporate Moyle Holdings Limited (MHL¹) into Northern Ireland Energy Holdings Limited (NIEH²). The incorporation would create a single holding company for Northern Ireland's UK-linking energy assets following NIEH's successful acquisition of the regulated gas transmission utility, Premier Transmission Limited (PTL³). This paper sets out the Authority's decisions on the issues raised.

The July consultation focused on three key issues:

- Are the benefits of the incorporation of MHL into NIEH sufficient to justify the new company structure?
- Are the corporate governance arrangements of NIEH sufficient to ensure the transparency and accountability of the new company structure?
- Are the corporate governance arrangements of NIEH sufficient to prevent potential conflicts of interest?

The Authority also welcomed any additional views or comments from all interested parties regarding benefits or risks that were not specifically identified and addressed in the consultation.

In total there were 8 responses. A list of the publicly available responses is included in the Appendix, and all responses can be accessed from the website of the Office for the Regulation of Electricity and Gas (Ofreg) at <http://ofreg.nics.gov.uk/>.

¹ MHL is the holding company of Moyle Interconnector Limited (MIL), which own and operate the Moyle Interconnector infrastructure and assets.

² NIEH is a not-for-profit 100% debt financed company limited by guarantee.

³ PTL own and operate the Scotland to Northern Ireland Pipeline (SNIP).

The Authority's Analysis

The Authority takes the view that the proposed incorporation will lead to significant cost savings for electricity and gas consumers. These cost savings will arise from the sharing of management and administrative functions, as well as costs savings in relation to joint outsourcing such as the procurement of maintenance and other service contracts. In addition the proposed structure will give rise to tax benefits by allowing NIEH to avail of group relief on losses expected at PTL in the initial years against profits made by MIL.

The Authority also takes the view that the proposal will create a much more robust structure for management of the two mutualised energy companies. This will (1) facilitate the provision of mutual support and contingency cover; (2) facilitate any future energy asset acquisitions by NIEH; and (3) create a holding company with sufficient influence and capability to act in the long-term interests of energy consumers.

A number of respondents agreed that the suggested savings would be welcome but questioned where specifically such savings would be made. Significant savings will be made by using a joint services company (the JSC) to provide administrative services to both the Moyle and SNIP group of companies, and to procure maintenance and other service contracts on behalf of both groups of companies.

For example an administration support team working in the JSC will:

- Provide human resource functions for all employees (i.e. payroll, pension administration);
- Provide general office administrative services for both groups of companies (i.e. secretarial support, record keeping);
- Organise and facilitate meetings of the boards of MIL and PTL;
- Provide administrative support to the boards of MIL and PTL;
- Negate the need for MIL and PTL to have separate staff and office space for the above functions.

The JSC will also jointly procure maintenance and other service contracts (where possible), resulting in savings where duplication of such contracts currently exists or where greater purchasing power would lead to discounts. Examples include:

- Joint procurement of emergency repair equipment and crew currently contracted separately to provide cover for the Moyle Interconnector and SNIP;
- Joint procurement of the bi-annual inspection of each interconnector, again currently contracted separately;
- Joint procurement of accounting and auditing services.

The two lists above provide only a few examples of the expected savings made by the JSC.

A number of respondents expressed concerns about transparency, accountability and the potential for conflicts of interests to arise in the proposed company structure. Doubts

were also aired regarding the ability and/or intent of the Membership to act in the interests of energy consumers.

As described in the consultation paper, the Authority's view is that the corporate governance arrangements in place at NIEH are sufficient to ensure transparency and accountability, as well as prevent any conflicts of interest. The supporting arguments were clearly stated in the paper and the Authority stands by its initial assessment. The Authority also reiterates that whilst the proposal will result in the incorporation of MIL and PTL into NIEH, this will not change the safeguards of their respective licences which must continue to be complied with.

Regarding the issue of the ability and/or intent of the Membership to act in the interests of energy consumers the Authority restates the following:

- Appointment of Members is made by the board of NIEH, but only after receiving recommendations from the Membership Selections Committee (the MSC). With two representatives on the MSC the Authority retains significant influence on the Membership make up. This allows the Authority to ensure it is comprised of individuals who have due regard for the interests of energy consumers.
- Although Members will be appointed on a personal basis, many will have been appointed following nomination from key stakeholder and consumer groups. We expect them to seek to minimise costs to Northern Ireland energy consumers.
- Clause 3.6(i) of the Membership Policy states that Members must “*conduct themselves in a manner which will maintain and strengthen the public's trust and confidence in the Company [NIEH] and avoid any action which would, or could, bring the Company's name and reputation into disrepute*”. We believe that any action that is detrimental to the interests of energy consumers would be contrary to this Clause.
- The Authority will monitor the actions of NIEH and make public any concerns it has if it feels NIEH is not acting in the interests of Northern Ireland energy consumers.

A number of respondents questioned the benefits of the mutualisation model. The view was also expressed that the consultation implies the Authority is a proponent of the model of asset mutualisation.

Firstly the wider issue of the merits of the mutualisation of energy assets is beyond the scope of this consultation and has been consulted upon in September 2002. Secondly the Authority wishes to state it is not a proponent of mutualisation, rather it considers each case individually and on its merit. The mutualisation of the Moyle Interconnector and SNIP were supported due to an expectation of significant savings to energy consumers. To date the mutualisations have delivered just that. If in future the mutualisation of additional energy assets is proposed, the Authority will analyse and consider the proposal in line with its statutory duties.

Some others respondents voiced concerns that the proposal will hinder the reduction in the cost of electricity and limit competition in electricity supply.

A primary driver of the incorporation of MIL into NIEH is cost savings, which can be passed on to energy consumers. The Authority reiterates that surpluses generated by NIEH, if any, must receive the Authority's approval before it is used and the Authority can dictate that any surpluses are returned to energy consumers. As always, in making these decisions the Authority must have regard to its statutory duties which should give all parties comfort.

Furthermore if NIEH should seek to acquire and mutualise additional energy assets, it will do so for the very reason that the mutualisation will lead to additional cost savings for energy consumers. With regards to competition, the Authority will continue to monitor NIEH and ensure compliance with all relevant EU competition directives.

As a final comment the Authority is of the view that, given the corporate governance rules and licence safeguards in place, no significant additional risks will be borne by energy consumers. Also the proposal is unlikely to increase the potential for systemic energy industry failure. One could argue the new company structure is likely to lead to faster corrective action in the event of an emergency at one of the companies. This will result from the greater resources and purchasing power of the consolidated group and greater integration of risk management systems that will be put in place.

In summary, the Authority believes the benefits of the proposal outweigh the risks and will be beneficial for energy consumers of Northern Ireland. Accordingly the Authority has no objection to the incorporation of MHL into NIEH.

Next Steps

Before any action is taken, the boards and the Memberships of MHL and NIEH will both have to approve the proposal. The Annual General Meeting (AGM) of MHL is scheduled for 12 October 2005, and it is envisaged that an Extraordinary General Meeting (EGM) of MHL will be called to coincide with the AGM. NIEH will also schedule an EGM to coincide with the MHL AGM/EGM. The proposal can then be tabled and discussed at the EGMs.

Following an agreement, NIEH's board of directors will be responsible for the necessary work to complete the incorporation. This includes negotiations with the respective financiers of MIL and PTL, amendments to contractual and ancillary agreements, and all other requisite tasks.

The Authority will not have a significant role in the incorporation process, other than closely monitoring proceedings. Once the new structure has been put in place, the Authority will continue to monitor the activities of both MIL and PTL. This should provide comfort that each energy asset continues to be operated and managed in a prudent manner.

Further Information

Interested parties seeking further information should contact Carl Hashim or Brian McHugh at Ofreg. Contact details are as follows:

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Appendix – List of Consultation Respondents

- Northern Ireland Energy Holdings Limited and Moyle Holdings Limited – a joint response was submitted by the boards of NIEH and MHL
- John Simpson
- Airtricity
- Northern Ireland Electricity
- Phoenix Natural Gas Limited
- Centrica
- General Consumer Council for Northern Ireland
- Coolkeeragh ESB