# The Proposed Acquisition of Premier Transmission Limited

# **A Decision Paper**

Northern Ireland Authority for Energy Regulation

November 2004

# The Proposed Acquisition of Premier Transmission Limited - A Decision Paper following responses to the Consultation Paper issued on 10th September 2004

## Section one Introduction

The Authority issued a consultation paper on 10th September 2004 seeking responses[1] on issues raised by the proposed acquisition of the regulated gas transmission utility, Premier Transmission Limited (PTL) by a subsidiary of a not-for-dividend 100% debt financed company, Northern Ireland Energy Holdings Limited (NIEH), hereafter also referred to as the CLG (company limited by guarantee). This paper sets out the Authority's decisions on the issues raised.

To facilitate the acquisition, two statutory consultations are being issued. These relate to

1. New Conveyance Licence to PTL. This is to reflect the new regulatory framework and consumer safeguards described in this paper and will extend the period for which the licence is granted.

2. proposed Designation Order to be issued by DETI, under Article 60 of the Energy Order 2003. This reflects the longer financing period following the PTL acquisition. This will be issued shortly.

The September consultation paper focused on 6 key issues:

(a) The benefits and risks to consumers associated with the proposal, in particular whether any benefits and risks had not been assessed.

(b) The financing arrangements; specifically the duration of the financing period.

(c) The proposed company structure - views were sought on the creation of a parent energy holding company and the extent to which there

[1] A list of the publicly available consultation responses is in Appendix 3

should be some overlap in the membership and Board of Directors of Moyle and PTL.

(d) Governance arrangements, in particular the appointment of members, the need for public recruitment and the role of the Authority in the appointment of members as well as the links between governance arrangements and the maintenance of efficiency.

(e) Management incentives.

(f) The Collection Agency Arrangement (being the proposed contingent guarantee from electricity consumers).

## Section two Summary of Authority's Decision

The Authority takes the view that the proposed acquisition has the potential to reduce costs for electricity and gas consumers and that there is also the potential to further reduce costs by identifying further investments by the CLG in infrastructure assets which are beneficial to consumer interests.

The Authority recognises, however – and this was reflected in the consultation responses – that the mutualisation route brings with it the potential transfer of risks to consumers; the key risk is that the efficiency drivers associated with conventional equity based limited companies may be absent. The absence of RPI-X regulation, which is the norm for regulated monopolies, adds to this concern.

With respect to this specific proposal, there are also concerns that what is being proposed is a more complex arrangement than Moyle. Key concerns expressed in the consultation responses have been (a) the proposed merger of Moyle into a larger group under the CLG, (b) the potential for some of the revenues/surpluses to be used in ways which might not be regarded as in the public interest, and (c) a potential lack of transparency in the governance arrangements.

The Authority believes that these concerns have been addressed by the decisions detailed below, particularly with respect to governance arrangements, management incentives and its decision to delay the merger of Moyle into the NIEH group, pending further consultation once the arrangements for the current proposal are in place and judged to be satisfactory.

The Authority however sees itself as having an ongoing role in monitoring NIEH and in particular its regulated subsidiary(ies). It sees this happening in the following ways:

(a) By retaining an on-going role in the selection of members for NIEH through its ability to nominate two of the six members of the selection committee;

(b) The monitoring of the controllable operating costs of the regulated parts of the business against the estimates of these costs (subject to review) agreed between the Authority and PTL ;

(c) Monitoring as part of this process any costs being charged by other members of the NIEH group;

(d) Agreement on the use of the potential surpluses, referred to in Appendix 2; and

(e) Requirements that PTL provide information to the Authority when asked to do so.

The Authority's ability to carry out its role will be reflected in a number of key licence conditions outlined in Appendix One as well as the various Memoranda and Articles of Association of NIEH and associated companies which will be approved by the Authority before the new licence is granted. It will be a condition of PTL's licence that it does not amend its memorandum or articles of association without the approval of the Authority. NIEH will also be required to provide an undertaking that it will not, and will procure that certain other group companies will not, amend their memoranda or articles without Authority approval.

## Section three Decisions on Key Issues covered in Consultation

### (a) The benefits and risks associated with the proposal

The consultation paper identified two categories of savings to the consumers resulting from the transfer of the ownership of PTL to the CLG structure:- capital savings and operating cost savings. The first of these results from lower financing costs. After the costs of the transfer have been included, savings with a Net Present Value in the range £27m-£36m have been estimated which equates to £4m to £5m per annum before 2021; the actual savings depending crucially on the discount rate and terms of financing, particularly the profile of debt repayment.

The second category of savings comprises broadly three types - the difference between the actual operating costs being incurred by PTL and what is allowed in its existing licence; potential efficiency gains resulting from relocation of the administration and operations of the pipeline from England to Northern Ireland; and the avoidance, post 2021, of a management fee for operating the pipeline.

Responses to the consultation paper recognised the potential for significant consumer savings as a result of the proposal. Some respondents queried why the savings as a result of the transfer of operations from England to Northern Ireland, were not already being achieved by PTL under existing ownership. There will be an expectation from the Authority and consumers that these savings, having now been identified, will materialise under the new CLG ownership structure.

The consultation paper identified the potential risk over time for the dilution of the above savings once the profit maximising incentive associated with the current equity-based model is removed. The paper also recognised the potential for reductions in efficiency and hence increased costs if, as proposed, the normal constraints of RPI-X regulation were removed from PTL as part of the mutualisation arrangements. Under the arrangements for regulating this pipeline the normal RPI-X methodology did not apply to PTL. Nevertheless this concern was widely echoed in the consultation responses.

In the consultation paper the Authority took the view that customers could be protected against the risk of inefficient management of costs through appropriate governance arrangements. These are dealt with later in the paper but in the view of the Authority require the following elements:

- Processes which ensure the selection of members of the CLG with the experience and commitment to require that directors carry out their duties;
- Processes which ensure the selection of competent and experienced non-executive directors of the CLG and other companies in the NIEH group;
- Transparency in the operation of the CLG which ensures that members, the Authority and the wider public can monitor its activities and thereby satisfy themselves that the public interest continues to be served; and
- Development by the Authority of a robust process to review PTL's estimates of its controllable operating expenditure with appropriate incentives for outperformance by the company.

The consultation responses did not identify any additional risks and benefits which had not been assessed in the Authority's consultation paper except the unlikely possibility of sufficient gas finds off the Irish coast to making the SNIP surplus to requirements. This would be a 'problem' we would be glad to have to confront.

**(b) The financing arrangements - key parameters**

The tenor (i.e. length) of the financing is now set at 25 years with a bond due to mature on 31st January 2030, which matches other commitments on the postalised network and is thus the tenor that achieves the best cost of financing.

Decisions on many of the financing details are nearing completion, with the key decision to pursue a bond financing having been made. Two decisions however - the capital and interest payment profile and whether or not to index the financing to inflation - are matters for the Authority.

The Authority's decisions on these are based on current and expected costs and demand on the postalised network over the financing period.

In this context the Authority considers that a 25-year financing, on an index-linked basis with a slightly escalating capital/interest re/payments profile to generally match capacity usage on the postalised network, generates an appropriate profile of capital cost savings. The index linking of debt repayments will depend on the availability at financial close of a suitable derivative instrument. This will advantage development in the distribution networks in earlier years while keeping capital payments on the mutualised SNIP to an acceptable level in later years.

The decision to limit the financing period to 25 years is consistent with responses received on duration of the financing period, all of which supported the duration of the financing period at the shorter end of the spectrum. The lack of savings in the last years of the financing period does not of course mean prices will rise; merely that an expected price fall in those years will not take place. Even this effect will be lessened by the larger and earlier growth of gas volumes.

**(c) The proposed company structure**

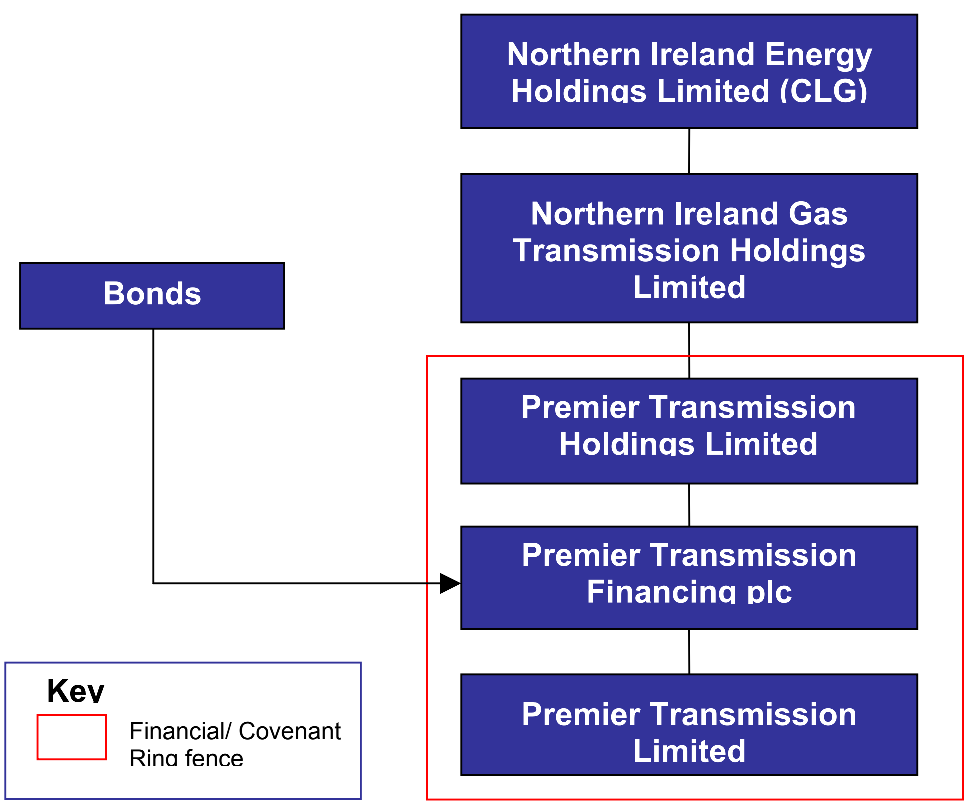
The consultation paper put forward, as a possible option, the formation of a new holding company NIEH, which would be a CLG and which would have ownership of and control over the Moyle and SNIP assets. The rationale for such a move was twofold:- the potential efficiency benefits, including cost savings from joint outsourcing and the sharing of management and administrative functions, and the setting up of a structure which would facilitate the ability to acquire and finance additional energy infrastructure assets in Northern Ireland, in particular the mutualisation of the Phoenix transmission asset which was part of the recent agreement with Phoenix and whose inclusion would deliver further substantial savings for gas and electricity consumers.

The proposed structure envisages PTL being acquired by a newly incorporated subsidiary of NIEH, with a structure below that similar to Moyle – three companies, Premier Transmissions Holdings Limited, Premier Transmissions Financing plc and PTL. Similar to Moyle, Premier Transmission Holdings Limited will own 100% of the share capital of the financing company, Premier Transmission Financing plc, which in turn will own 100% of the operating company, PTL. Like Moyle, PTL will be a regulated business operating within its own regulatory ring fence. Also like Moyle it will be independently managed with a Board of Directors (comprising executive and non-executive directors) with sole responsibility for the interests of the company.

NIEH will indirectly hold the shares of PTL and, prospectively, any future gas transmission acquisitions. The Directors of NIEH will comprise the non-executive Directors of Moyle and PTL.

Responses to the consultation paper expressed, in most instances, reservations with respect to the proposed structure. Broadly two concerns were raised – lack of transparency and accountability in the governance arrangements for the new structures and potential conflicts of interest. The Authority has had discussions with members of the putative board of NIEH and has agreed a number of key changes with regard to the appointment of the its members which it believes addresses the first of these concerns. These are outlined in the next section of this paper.

On the second issue the Authority takes the view that the ring-fencing of Moyle and PTL, the proposed regulatory regime /licensing arrangements and the appointment only of non-executive directors from each of the ring-fenced companies to the CLG Board should preclude conflict of interest problems. However in order that this issue can be given further thought the Authority is proposing to postpone any decision on the migration of the membership rights of Moyle to the proposed CLG until after the PTL transaction has been completed and the governance arrangements for NIEH and associated gas transmission companies have been put in place and are deemed to be satisfactory. The incorporation of Moyle into the new structure will therefore be subject to a further separate consultation planned for early 2005. In the meantime the proposal for joint administrative arrangements for the two companies will not be implemented.



The Authority however endorses the remaining structure as outlined above. This in essence replicates the Moyle structure with the inclusion of an overall holding company which provides the flexibility to acquire and finance additional energy infrastructure assets in Northern Ireland if appropriate. Any such acquisitions will require the support of both the members of NIEH and the Authority. The proposed structure is set out in the diagram above.

**(d) Governance arrangements, in particular the appointment of members**

In its consultation paper the Authority recognised the need for the governance structure of the new CLG and associated companies to be aligned with consumers' interests. Key to this was the appointment of a competent group of members who were motivated to ensure that the Board and management of the CLG and associated companies acted in consumers' interests. For this to happen three key requirements were identified:

- transparency in the appointment process;
- diversity of membership with adequate representation of users/consumers; and
- accountability.

This was an issue on which there was considerable interest in the consultation responses and there was considerable support for the three requirements identified above. In discussions with the putative Board of NIEH it has been agreed that the memorandum and articles of the new CLG will meet these requirements as follows:

<u>Members - appointment process</u>

(a) Members will be selected on merit and against objective criteria, with the aim of securing a membership which has the skills, knowledge and experience to represent effectively consumer interests.

(b) There will be a minimum of 30 members sufficient to incorporate all relevant interests but few enough to ensure that each member takes responsibility and that the Board can manage effectively.

(c) A selection panel will be set up to carry out the task of appointing members. It will be comprised of two independent members, two non-executive directors of NIEH and two independent persons nominated by the Authority.

(d) Members will be selected through two routes- key stakeholders will be asked to put forward candidates for consideration (in the first instance it is expected that nominations will be sought from the GCC, CBI, IOD UFU and NIC/ICTU); in addition there will be an open recruitment process similar to that used for public appointments. The split between the two is expected to be roughly 60/40.

(e) Selection will be based on the nominee's ability to meet the criteria for membership as well as the need to ensure a balanced membership.

(f) Maximum tenure for members will be three consecutive three year terms with renewal requiring approval by the selection panel.

(g) The NIEH Board will consist solely of non-executive directors and only NIEH non-executive directors will be non-executive directors of the any associated gas transmission company (currently only PTL).

(h) Maximum tenure for non-executive directors (for all NIEH companies) will be two consecutive 3 year terms with appointment and renewal requiring approval by members at AGM.

<u>Members –role, duty and responsibilities</u>

Members' roles, duties and responsibilities will be substantially the same as those of shareholders in a listed company.

i. At AGM Members vote on a number of resolutions including:

   - election of any newly appointed Directors
   -re-election of any Directors who are retiring on 3 year rotation
   -adoption of the accounts
   -appointment/reappointment of auditors
   -remuneration committee report

ii. Members (10%) have right to call an EGM

iii. Members are only entitled to receive expenses- no remuneration.

The above arrangements will be contained, in the Memorandum and Articles of Association of the CLG and associated companies, or in licence requirements. Prior to receipt of a licence the Memorandum and Articles of Association of NIEH and its associated companies will be made available to the Authority and there will be a licence requirement that any changes will require the approval of the Authority.

In addition to the specifics above it is intended that NIEH and associated companies should be seen to be adopting best practice by adhering where appropriate to the new Combined Code on Corporate Governance which has been devised for listed companies. The principles of the code with regard to accountability, transparency and effectiveness will be reflected, to the extent appropriate, in the Memorandum and Articles of Association of NIEH and associated companies.

Interim Arrangements

The above arrangements will not be fully in place prior to the acquisition of PTL and the grant of the new PTL licence. Interim arrangements lasting up to the first AGM have therefore been agreed between the putative board of NIEH and the Authority. It has been agreed that the five current non-executive directors of Moyle Holdings Limited will become the non-executive directors of NIEH with that number expanded to seven subsequent to the sale. Moyle members will also move to NIEH though with their initial terms of appointment limited to 2 years.

The first General Meeting will take place within 6 months of the acquisition of PTL and the appointment of the new members under the arrangements outlined above should have taken place by that date. During the interim period any decisions which would normally require the approval of members will require consultation with the Authority. As already noted above the Moyle CLG will only be incorporated into NIEH after further consultation by the Authority.

### (e) Management Incentives

The Authority in its consultation paper indicated the need for incentives to ensure that the SNIP pipeline is operated in an efficient and effective manner and that the savings resulting from lower financing costs would not be diluted by inefficiencies in the management of operating costs. Good governance arrangements including monitoring by a competent, motivated and broadly based membership will much contribute to this goal; the requirements for the selection of such a membership has been addressed earlier in the paper. Also important is the ability of the Authority to monitor the activities of the CLG and associated companies again to ensure the public interest is preserved; this was discussed above. A further component however is the need to ensure that management is incentivised to control costs in a manner compatible with safety and longer-term efficiency and that there is a link between pay and performance.

To a large extent many of the operations associated with managing the pipeline will be put out to tender and much of the management focus will be on managing these contracts. That said, there should be a requirement on the Board of PTL and ultimately the Board of NIEH to put in place arrangements which incentivise management to act in ways which meet the needs of consumers. Responses to the consultation were supportive of this.

**(f) The Collection Agency Arrangement (CAA)**

The consultation paper discussed the possibility of using electricity consumers as a guarantee support to underpin the financing. The benefit of this arrangement was estimated to be approximately £200,000 each year. A number of respondents raised significant concerns on this proposed risk sharing between the gas and electricity markets. After receiving comfort from the financiers that the acquisition can continue to proceed on reasonable terms without the arrangement, the Authority has agreed to removal this from the proposals.

However the Authority does recognise that the financiers perceive a risk that future regulatory actions could negatively impact on PTL's ability to earn its revenue. To negate that risk, we believe that a) the debt service coverage ratio should increase to 2.00x to increase the amount of reserves. If these reserves are not called on over the financing period, they are returned to consumers (plus any interest accumulated); and b) the Adverse Regulatory Event (ARE[2]) trigger originally contemplated as part of the CAA, should remain. This would allow PTL to over-recover, up to an amount equal to the debt service cover ratio "uplift", in the event that a

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[2] The definition of an ARE will be any conduct of a relevant regulator (or the preparation of any draft legislation/regulation) which has the potential to undermine the robustness of the financing structure.

potential or actual regulatory action occurred. If the circumstances surrounding the trigger of the ARE do not persist, then any over-recovered amount will be returned to consumers, otherwise over-recoveries may be used by the financiers to reduce the debt liability outstanding.

The Authority believes this is a sensible arrangement. The Board have to consult the Authority before triggering the ARE over-recovery and also the members of the NIEH will ensure that Board only trigger when it is absolutely necessary. It is beyond question that, through the postalisation arrangements, Northern Ireland consumers are already committed to paying for the SNIP pipeline over its revenue recovery period. These arrangements enable PTL to collect extra funds to protect against the extreme situation where that commitment is broken, thus providing the reasonable protections necessary to allow a wholly debt funded acquisition to proceed.

**Section Four Process and Timetable**

The acquisition of PTL will be done by selling the shares to Premier Transmission Financing plc (the finance company in the structure that will issue the bonds). Hence Premier Transmission will continue to be the business name under the new ownership. A new licence is needed to facilitate this acquisition because a longer Licence Grant period (the period during which the Licence cannot be revoked without due reason) is needed for the financing. The new licence, which will contain the range of special conditions which the Authority feels are necessary for this CLG structure, will become effective on the day when the share transfer occurs. Therefore PTL under its new ownership will be obliged to comply with the new licence.

The Authority will also issue a comfort letter to PTL and the financiers in terms to be agreed, addressing certain matters, including:

- consultation with PTL prior to proposing any modifications to the PTL licence;
- consideration of any eventual application for a new conveyance licence for the SNIP network by a person nominated by the security trustee under the financing in the event of a revocation of the PTL Licence or other default under the financing.

**Postalisation Tariff Reduction in 04/05 gas year**

Condition 2A 2.5.4 of the Postalisation Conveyance Standard Conditions enables the Authority to amend the tariff to take account of possible designations. SNIP will be redesignated over a longer period to facilitate this acquisition. Therefore the Authority has decided to reduce the postalisation tariff on financial close to give consumers an immediate saving from this transaction. The extent of the reduction will be decided closer to financial close.

Going forward the expected timetable is:

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| NIAER issues Decision Paper | 19th November |
| NIAER issues draft conveyance licence for consultation | 19th November |

| | |
|---|---|
| DETI issues draft Designation Notice for consultation | 19th November |
| Deadline for comments on draft licence consultation | 17th December |
| Financial Close | End Dec/Early Jan |

The Licence will be issued at Financial Close

## Appendix one: Summary of the Proposed Additional Licence Conditions

In order for the Authority to approve the acquisition we have proposed a range of additional licence conditions in consideration of the specific nature of the new ownership. These conditions emerge from the decisions discussed in this paper and are compatible with those licence conditions established for the Glas Cymru and Network Rail Company Limited by Guarantee structures. Team Northern Ireland on behalf of the new licensee, have agreed to these conditions:

<u>Corporate Governance [licence condition 3.2]</u>

This requires PTL to, amongst other things:

- comply with the terms of its Memorandum and Articles of Association
- have non-executive directors of appropriate standing who shall be greater in number than the executive directors
- not change its Memorandum and Articles of Association without the consent of the Authority
- comply, where appropriate, with Principle of Good Governance and Code of Best Practice as approved by the UK listing Authority

PTL is also required to procure from its Parent Company, NIEH, a legally enforceable undertaking in favour of the Authority that it and the companies in the direct chain of ownership of PTL will do likewise and also will not undertake any action that would cause PTL to be in contravention of its licence.

<u>Financial ring-fencing [licence conditions 3.2.6 to 3.2.9]</u>

The licensee is prohibited from carrying out any activity outside the licensed business.

The licensed business is defined as the conveyance of gas through SNIP and related activities, entering into and performing its obligations under the financing arrangements and any other activities (including social enhancement projects) that the Authority may approve from time to time.

The licensee is prohibited from owning any shares in other companies (other than in the ordinary course of its business) or any other investments.

Without the Authority's consent, the Licensee cannot**:**

- create charges, grant security, undertake indebtedness or guarantee any obligations unless such transactions are on an arm's length basis, on normal commercial terms, for a "Permitted Purpose" and, in certain circumstances, in compliance with licence condition 1.12; or

- enter into certain transactions with its affiliates or related undertakings (although PTL can enter into a limited number of types of transaction with its affiliates or related undertakings, such as the payment for goods or services that are provided on an arm's length basis and on normal commercial terms); or

- make loans to affiliates or related undertakings, other than for a "Permitted Purpose".

The licence defines a "Permitted Purpose" as a purpose that relates to the licensee's business, is allowed under licence condition 1.12 or is one of the permitted transactions with PTL's affiliates or related undertakings. Licence condition 1.12 places restrictions on PTL's ability to dispose of or charge its assets.

<u>Operational Obligations [licence condition 3.3.1]</u>

The licensee is required to act as a "Reasonable and Prudent Operator" in securing the objectives of:

- maintaining the capacity and functionality of SNIP; and

- optimising the efficiency, reliability, availability and operational life of SNIP.

The concept of "Reasonable and Prudent Operator" provides an objective measurement of PTL's performance of those objectives.

Procurement [licence condition 3.3.2]

The licensee has an economic purchasing obligation in relation to the procurement of works and services, including pipeline maintenance services, survey and inspection services and repair works.

PTL is required to obtain these services from the most economical source available to it.

The Authority has the ability to request at any time details of PTL procurement policy and contracts and an explanation of how its procurement activities are consistent with its operational obligations referred to above.

Management Incentives [licence condition 3.3.3]

The draft licence requires PTL to send, if requested by the Authority, a management incentive plan outlining the remuneration packages and incentives schemes for key members of staff. In formulating any Management Incentive Plan, PTL shall have regard to such criteria as it considers to be appropriate in all the circumstances, which may, without limitation, include:

a. Safety
b. Reliability and performance of the pipeline
c. Fulfilment of contractual and licence obligations
d. Maximising the availability of the pipeline
e. Maximising available capacity which is economical
f. Openness and Transparency of operations through regular reports to industry.
g. Operational expenditure performance

The consultation responses agreed with this list of factors.

Single Transmission System Operator [licence condition 3.3.4]

The licensee will be obliged to co-operate with any arrangements to implement a single transmission operator in Northern Ireland (subject to that co-operation not putting PTL in breach of any statutory obligations, affecting its financing arrangements or putting it in breach of the licence).

## Appendix two: Explanation of the Financing and Price Control conditions in the licence

The Allowed Revenue Condition (licence Condition 3.1) contains a number of similarities with the existing PTL licence. In particular, the "UC" term for calculating Stranraer revenue and the Committed Shipper payment are replicated into the new licence and the effect of these conditions remains the same.

The key differences from PTL's existing allowed revenue arrangements are:

(i) the current capital expenditure recovery terms are replaced by the term Fixed Amount. The Fixed Amount for each Gas Year will be defined in a letter from the Authority to PTL to be issued by the Authority (the **"Direction"**) at completion of the purchase of PTL.

The Fixed Amount recoverable by PTL will be sufficient to cover principal and interest repayments under the bonds to be issued as part of the financing arrangements and (if put in place) payments under any index-linked instrument referred to in paragraph (b) of Section three to maintain the debt service ratio of 2.00x to ensure that PTL is in compliance with its financing documents; and

(ii) the current operating expenditure terms are replaced by the concept of Eligible Pass Through Costs. The definition of Eligible Pass Through Costs will be set out in the Direction but will include the following items:

- Costs incurred in operating and maintaining the Network
- Insurance Costs
- BGE Scotland Upstream Costs
- Costs associated with the financing transaction (i.e. annually credit rating reviews/Liquidity Facilities Fees)
- Costs incurred by the Parent Company, NIEH, associated with the licensee Business

As described in the consultation paper, the normal regulatory control over the pass-through of operational expenditure will be removed to improve the financing terms. The price control condition establishes this principle.

Through a combination of the Fixed Amount and Eligible Pass Through Costs, PTL is able to recover all of its costs and the costs of certain of its group companies incurred in a Gas Year.

The level of detail in the Direction plus the fact that the Direction cannot be amended without PTL's consents; improves the creditworthiness of the financing by providing PTL with certainty that it will be in a position to recover all of its costs in respect of any Gas Year. The Direction will only become effective on completion of the sale of PTL.

The Direction will not apply to Gas Years which commence after the final repayment of amounts due under the financing documents, which is expected to be in 25 years time. No later than 12 months prior to the anticipated date of the final repayment the Licensee will be obliged to put forward a proposed alternative charging methodology to deal with the on-going operational costs and possible decommissioning costs (the probability of decommissioning is very small and will only be included in allowed revenue following expert determination). The methodology will require the Authority's approval. It is sensible to leave the question of how to price control a company of this nature once the financing has been repaid to that time.

As with its existing arrangements, under the proposed licence PTL's Actual Allowed Revenue at the end of the Gas Year can differ from it's Forecast Allowed Revenue recovered in respect of that Gas Year. Under Postalisation, any difference will feed through the year-end reconciliation charge/rebate. There are no requirements to change the Postalisation tariff mechanism to reflect the new ownership structure. PTL will continue to be treated equally with the other transmission operators.

***Company Incentives – allowed use of surplus***

The proposed licence contains a provision for the retention by PTL of any surplus to act as an incentive on PTL to explore projects that improve the energy market. The licence defines a surplus as the difference between actual expenditure and the Authority's determination of the efficient level of expenditure on those costs judged to be within PTL's control. The question of an incentive mechanism was raised in the consultation paper. There are two stages to any possible retention of a surplus:

- Determining the amount of any surplus at the end of the Gas Year. The amount of any surplus will be dependent not only on performance in the Gas Year in question but also in previous years. Any deficit occurring in the previous three years will be netted off in the calculation of the surplus for any Gas Year.

- Authority approval for the surplus to be retained. The Board of PTL's ultimate parent company, NIEH, has a direct interest in minimising NI energy costs and a keenness to use their skills in tackling these costs. Therefore PTL will be allowed to retain any surplus if the Board can demonstrates that the money will be spent on progressing energy cost reduction projects. If the surplus isn't used in such a way it will be rebated back to consumers in the postalisation year-end reconciliation mechanism.

There is also a condition (Licence Condition 3.1.12) to allow PTL under its new ownership to carry out the 2003/04 annual correction of PTL transportation charges under the new licence.

<u>Security Arrangements</u>
PTL and certain of its holding companies will be granting a comprehensive security package over all or substantially all of their assets in connection with the financing. The security package to be granted by PTL and such holding companies will include, without limitation:-

(a) fixed and floating charge debentures;

(b) security assignment of insurances;

(c) mortgages and other fixed security over interests in land, rights and benefits under contracts and other assets;

(d) assignments/assignations of contracts and other rights;

(e) bank account charges and charges (or mortgages) over shares of subsidiaries; and

(f) other related documents, including direct agreements and guarantees, in each case under the laws of Northern Ireland, Scotland and England (as appropriate).

The security package will also include fixed security over the entire issued share capital of PTL.

In certain circumstances detailed in the financing documentation (including on the occurrence of an event of default) the holders of the security will have the right to enforce it. On enforcement, amongst other things, the holders of security will be in a position to take possession/control of PTL's assets and the shares in PTL and sell the assets/shares to third parties. As part of the mutualisation arrangements, the Authority (subject to prior consultation with the Authority in relation to the identity of the proposed purchaser) will be required to relax its right of veto over any disposal of PTL's assets or change in ownership of PTL in the event that the security is enforced.

## Appendix three: List of Respondents to the Consultation Paper

The following are respondents who wished to make their comments public. Copies are available from our website: (http://ofreg.nics.gov.uk/index.html)

Phoenix Natural Gas
Bord Gais Eireann
NIE plc
Viridian Energy Supply ("Energia")
CBI
Sinn Fein
Ulster Unionist Party
General Consumer Council for Northern Ireland