

Northern Ireland Energy Holdings Corporate Governance Review

Utility Regulator Consultation Paper

Northern Ireland Energy Holdings (NIEH) Response

09 April 2009

Summary

NIEH welcomes the Utility Regulator's commitment to providing regulatory oversight of the NIEH group of companies to ensure that all aspects of the structure are performing satisfactorily. A company limited by guarantee (a.k.a. mutualised company) is not the norm in the energy industry. However NIEH is convinced its structure has already proven its worth in terms of benefiting consumers through lowering the cost of capital of energy infrastructure and has the potential to be applied more widely. NIEH also recognise that some parties may still not be convinced of the merits of such a business structure due to the lack of direct personal financial motivation within the governance body. The results of this review we believe goes a long way to dispelling such a view.

NIEH is convinced that its governance structures are robust and effective. We are pleased that the regulator having carried out a thorough review of the arrangements has come to a similar view.

The NIEH governance review provided the regulator with complete transparency of the operations of NIEH, way beyond the transparency available in non mutualised energy businesses. NIEH was happy to fully cooperate with the review team.

NIEH are pleased that the review concluded that:

- The Combined Code is the most appropriate model for the governance structure of the company
- NIEH compliance with the code has been demonstrated through the review

Some minor recommendations were made and NIEH is content to address these. The remainder of this paper deals with the individual recommendations and NIEH's response to these.

Governance

The Corporate Governance Standards against which we were judged were those applicable to listed plcs, the highest standards in the UK framework, with expectations set by Ernst and Young based upon NIEH's maturity. No non-compliances with the combined code were noted however Ernst & Young did make the following recommendations designed to enhance compliance:

1. NIEH give consideration to implementing a Board Charter to outline roles, responsibilities and terms under which they operate;
2. that the existing terms of reference for each of the sub-committees of the Board are made available through the NIEH website; and
3. that the NIEH Members Selections Committee considers developing an assessment criteria for Members' performance.

NIEH accepts recommendations 1 and 2 and have since published the documents referred to in item 2 and are developing a Board Charter as proposed in item 1. We understand that Ernst and Young

did not have any specific issues with membership performance or process, however given the importance of the Members to NIEH governance and the lack of a direct financial incentive such as would be the case with shareholders, Ernst and Young have made the recommendation that a formal assessment of that part of the structure should be considered. The NIEH Members Selection Committee carry the primary responsibility regarding Members affairs. The committee consists of two non-executive board members, two members representatives and two independent persons appointed by the regulatory authority. The committee gave some consideration to this recommendation. They concluded that such a formal assessment could be useful however assessment of individual members should only be carried out at re-appointment so as not to create the potential to fetter their independence during their term. Additionally they concluded that selection of assessment criteria, other than attendance, may be problematic. The committee agreed to consider further following this Utility Regulator consultation process and feedback from existing members.

Remuneration

Ernst and Young concluded that remuneration levels, structures and review processes for the non-executive directors, the managing directors and the Group finance manager were in line with market standards.

A number of minor recommendations were proposed regarding senior management bonus payments:

1. the assessment of whether bonus targets set are appropriately stretching;
2. due consideration be paid to the “all or nothing” approach to bonus payments; and
3. the absence of a long term incentive plan to be taken into consideration when setting future bonus levels.

One of the roles of the remuneration committee (a sub-committee of the board) is to set performance targets for the senior managers and they ensure that these are appropriately stretching, consequently in effect no action is required to implement item 1 above, however the committee will bear in mind Ernst & Youngs comments. Item 2 has been accepted by NIEH and the Bonus scheme has been changed away from an “all or nothing” approach. The consultation paper recognises the difficulties introducing a long term incentive plan in a mutualised business, nevertheless item 3 will be considered by the remuneration committee with a view to addressing the issue.

Regulatory

Having assessed the licence conditions of the NIEH subsidiary companies the Utility Regulator has proposed that a number of changes:

1. The inclusion of corporate governance conditions within the Moyle licence similar to those included in the PTL and BGTL gas conveyance licences;
2. The addition into the Moyle Licence of the licence condition which allows the Utility Regulator for monitoring purposes to undertake a three year review of Moyle’s controllable operating expenditure; and
3. The review of the NIEH Membership Policy.

The consultation paper recognises that apart from the provision of an undertaking from the holding company, Moyle already complies with the proposed new licence requirements referred to in item 1 and therefore their introduction is really just formalising existing arrangements.

NIEH does not have any objection to the licence condition envisaged in item 2.

Any licence changes must be introduced via the formal licence change process, which includes agreement. NIEH does not have an objection in principle to the proposed changes, however it will need to ensure that the detail of the changes are in line with its expectation and are acceptable to its financiers.

NIEH accepts recommendation 3 to review its Membership Policy and is preparing to carry out the review which will involve consultation with its members and approval of any subsequent changes at its AGM in September 2009.