

**NORTHERN IRELAND AUTHORITY FOR UTILITY REGULATION
ASSESSMENT OF ESB CORPORATE FOR SEM COMMITTEE**

November 2011

Final Report

Submitted by:

Cambridge Economic Policy Associates Ltd.



CEPA

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1 INTRODUCTION

This paper has been prepared by CEPA for the Utility Regulator (acting on behalf of the SEM Committee) and provides a review of specific aspects of Northern Ireland Electricity's (NIE's) governance following its acquisition by Electricity Supply Board (ESB). It was prepared in parallel to the consultation on changes to NIE's Licence Conditions (the Consultation Document).¹

The review is not an audit, but rather an assessment of certain aspects of the governance structure in the context of protecting the interests of consumers in Northern Ireland. The findings set out in this paper are based on meetings and discussions with the Utility Regulator, NIE and ESB, on a comparative assessment of structures and policies in Ireland and GB and on the consultancy team's wider experience.

This report is structured as follows:

- Section 2 sets out background and context, including on NIE's position within the ESB group of companies;
- Section 3 sets out our understanding of information flows within the ESB group and from NIE in particular;
- Section 4 considers obligations to confirm (or otherwise) the availability of resources;
- Section 5 addresses issues relating to the definition of the "Ultimate Controller;"
- Section 6 considers the requirements on the independence of NIE's Board of Directors;
- Section 7 considers the rationale for allowing interaction between NIE and ESB Networks (ESBN);
- Section 8 considers controls on NIE procurement practices; and
- Section 9 summarises our overall judgement and recommendations from this review.

In addition to the body of the report, Annex A provides further information on the services provided by the ESB Corporate Centre.

¹ CER & NIAUR (2011) "*Single Electricity Market: Acquisition of NIE plc, NIE Powerteam and allied businesses by ESBNI Ltd*" SEM/11/011
<http://www.allislandproject.org/GetAttachment.aspx?id=a2f86a39-0d2c-4a62-b0e0-7392defbf4b1>

2 BACKGROUND AND CONTEXT

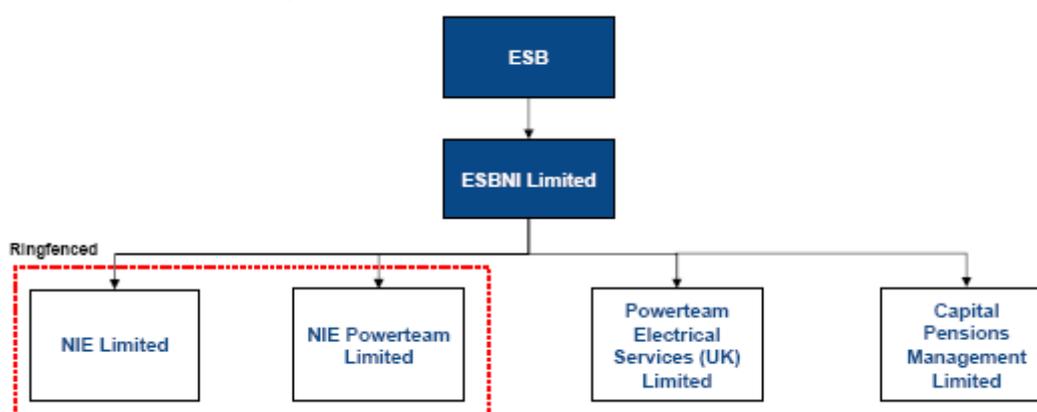
This section sets out relevant features of NIE’s post-acquisition position within ESB Group.

2.1 ESBNI

Following completion of the transaction on 21st December 2010, NIE became part of the ESB Group. NIE is directly held through ESBNI Ltd, a newly incorporated company established to acquire NIE and the Viridian Capital Limited companies (NIE Powerteam Limited, Powerteam Electrical Services (UK) Limited and Capital Pensions Management Limited).²

Figure 2.1 below shows how NIE fits into the ESB structure from a company law, group policy and governance perspective.

Figure 2.1: NIE within ESB Group Structure



Source: ESB presentation to CEPA 12/04/2011

We understand that NIE Powerteam Limited and Capital Pensions Management Limited, shown above in the new corporate structure, provide services solely to NIE. They have not been part of this review as they do not in our view create any new governance issues in the context of the acquisition:

- NIE Powerteam Limited only work for NIE, with costs treated broadly as an input/ bought in service to NIE, although with a profit element which is under review as part of RP5;
- Powerteam Electrical Services (UK) Limited is an unregulated specialist electrical construction and services contractor, reporting directly to ESB International, ESB’s group of unregulated businesses; and
- Capital Pensions Management Limited administers NIE’s pension scheme (formerly the Viridian Group Pension Scheme).

NIE Powerteam is separate to NIE but is deemed not to be an “Associated Business” under Condition 12 of NIE’s licence on the “Independence of the Transmission and Distribution Business,” and can sit inside NIE’s ring fence, as shown in Figure 2.1.³ The Licence requires that the NIE Compliance Manager must report if this arrangement lessens the independence of the

² Viridian Group Limited (UK) was previously the direct parent of NIE plc and Viridian Capital Limited.

³ Northern Ireland Electricity plc, “Participate in Transmission Licence,” Definitions, p82

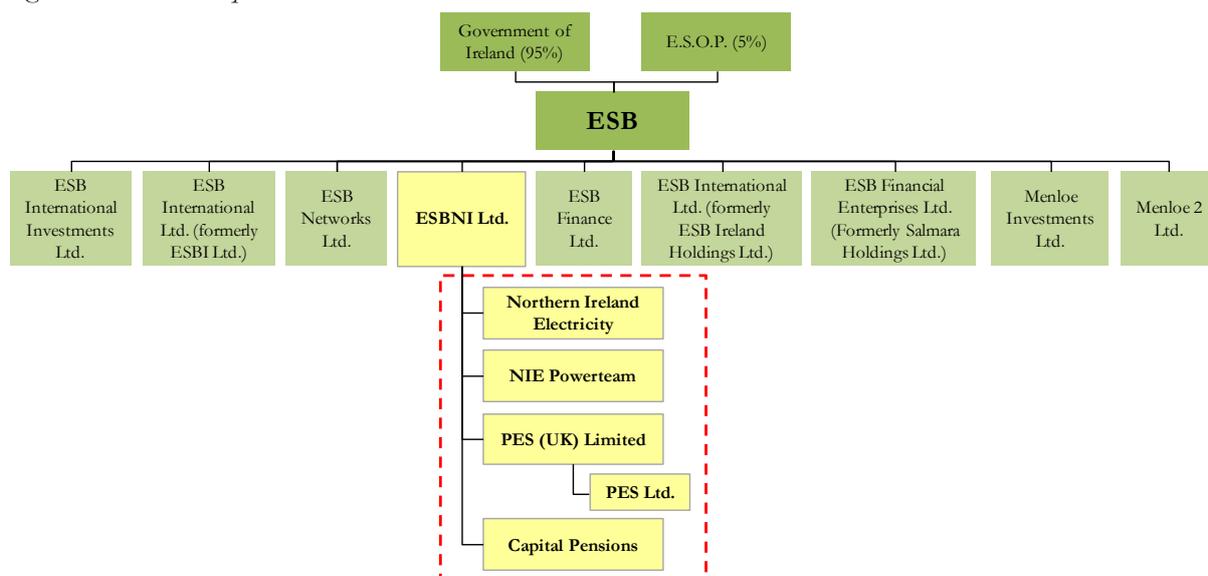
T&D business from businesses engaged in generation or supply on the Island of Ireland. We have not been made aware of any current concerns in relation to the NIE Powerteam business, although clearly now that NIE and NIE Powerteam are part of the wider ESB group, that independence is of even greater importance to market participants on the Island given the theoretical potential for conflicts of interest and anti-competitive behaviour, for example in relation to customer information.

Beyond the companies shown in Figure 2.1, NIE has five wholly-owned subsidiary companies. We understand that four of these companies were established for various historical reasons and none are now trading. We understand that the fifth, NIE Finance PLC, was incorporated as a wholly owned subsidiary of NIE on 28 April 2011 and is a special purpose finance vehicle (it was the issuer of the £400m bond issue in June 2011). As such, we do not believe that they are relevant to the findings of our review and are not discussed further in this paper. Fuller details have been provided to the review team by NIE.⁴

2.2 NIE governance and ESB

Figure 2.2 below shows NIE’s position within the wider group structure. While it is now clearly part of a much larger corporate group, it has moved from one vertically-integrated, ring-fenced structure to another: ESB note this in their (pre-completion of acquisition) letter of 15 June 2010 to the Chief Executive of NIAUR: “...ESB’s intention in acquiring NIE’s transmission and distribution assets is that NIE will continue to operate as a stand-alone business as it does today within a group structure, with the ESB Group structure substituting for the Viridian Group.” ESB does of course have a much more significant position today in electricity generation and supply on the Island of Ireland compared to Viridian, and it now owns network assets in Northern Ireland - it is therefore proper that the ring-fencing arrangements and governance structure are reviewed by the Utility Regulator on behalf of the SEM Committee in the interests of end-consumers.

Figure 2.2: ESB Group Structure



Source: ESB presentation to CEPA 12/04/2011

⁴ NIE shared a document titled “Note on the subsidiary companies of NIE” with the Utility Regulator on 18/04/11.

Based on our review, there is nothing in the ESB group ownership structure as of today that prevents the appropriate ring-fencing and governance of NIE, with the appropriate amendments to the NIE licence, but clearly day-to-day governance and appropriate management of NIE will depend on having appropriate policies in place and adherence to those policies by management and staff.

The relationship between NIE and ESB is governed through:

- NIE regulatory licence conditions;
- ESB undertakings, including the Agreement of 18 January 2011 between ESB and NIE procuring that each of its subsidiaries will refrain from any action which would be likely to cause NIE to breach any of its obligations;
- the Compliance Plan;⁵
- a Memorandum of Understanding, containing guidelines relating to the corporate relationship to exist between NIE and ESB – this forms Appendix 2 of the Compliance Plan; and
- Common Services Agreements (CSAs) for paid-for Group Services, as provided for under the Compliance Plan and where allowed by the Utility Regulator.

We note that the post-acquisition Compliance Plan and Memorandum of Understanding remain draft as of the time of writing. The remainder of this report examines whether the detail of these arrangements, as currently drafted, and any proposed amendments are fit for purpose given both the change in ownership and best practice in this area.

⁵ This review is based on the draft of December 2010.

3 ESB GOVERNANCE AND INFORMATION FLOW

This section addresses the governance arrangements in place at ESB and our understanding of information flows within the group. It sets out arrangements relating to:

- business separation;
- the Corporate Centre; and
- NIE specific arrangements.

It concludes with a brief set of recommendations.

3.1 Business separation

ESB is a vertically-integrated electricity company operating in both liberalised and non-contestable markets along the supply chain in the Republic of Ireland and on an All-Island basis.⁶ While ESB is a state-owned enterprise⁷ its primary economic regulator, the Commission for Energy Regulation (CER) require a series of measures to minimise the risk of abuse, given that ESB as a vertically integrated utility has the opportunity to abuse its position in the generation⁸ and supply markets for which it has responsibility.

Without ring fencing, ESB would potentially be able to take advantage of its privileged position in networks to give favourable treatment to its businesses operating in the liberalised supply and generation markets. Arrangements are also in place to control information that flows between the ESB Corporate Centre and the business units as part of its legitimate exercising of its corporate governance role or through its shared group services being treated in a way consistent with regulatory business separation (see Section 3.2 below). Ring fences, implemented through licence requirements, are in place to isolate ESB from all other Business Units (BUs),⁹ but also to separate generation businesses and to separate supply and generation.

CER required a number of regulatory and operational measures to prevent possible abuses of ESB's position as a significant vertically integrated electricity utility through:

- management, accounting, premises and systems separation of BUs; and
- controls on the movement of staff and confidential information.

ESB must be able to prepare accounts for each licensee as if they were “a free-standing corporate entity” and licences include prohibitions against:

- giving or receiving cross-subsidisation;
- direct or indirect communication of commercially-sensitive information;
- reporting directly or indirectly to other businesses within the group; and
- sharing of assets such as personnel, property or IT.

⁶ ESB are also active in GB and internationally.

⁷ Five percent of shares are held by the ESB Employee Share Ownership Plan (<http://www.esbesop.ie/>).

⁸ Market Power in the SEM is mitigated through a range of policies as approved by the SEMC.

⁹ ESB Networks, ESB Electric Ireland and ESB Energy International are ESB's pre-transaction Business Units.

Compliance reports are required annually confirming compliance with or breach of requirements and summary of compliance activities. ESB Network's 2009 *DSO Compliance Report*¹⁰ provides confirmation of no material breaches and of its compliance activity over the year and other agreements such as: use of arms-length operating and personnel agreements; the *Compliance Code of Conduct* in support of separation of the electricity network business, and briefing of staff and senior management on regulatory requirements.

The Networks business' *Compliance Code of Conduct*¹¹ provides an emphasis on compliance with licence requirements for confidentiality and non-discrimination, setting out treatment and dissemination of information, staff transfers and other policies for staff to regard in their daily business.

A further mechanism available in the Republic of Ireland is Statutory Instrument No 60 of 2005 (S.I. 60). S.I. 60 requires the Distribution and Transmission System Operators and the Transmission System Owner to "preserve the confidentiality of commercially sensitive information obtained by it in the discharge of its functions" and to "prevent information about its own activities which may be commercially advantageous being disclosed in a discriminatory manner." Contravention of this instrument can result in a fine of up to €3,000 on individuals guilty of these offences.¹²

3.2 Corporate Centre

Corporate Centre is the central hub in ESB acting in support of the Chief Executive to assist in strategy and governance of the group. Each licensed business or BU of ESB has their own decision making capacity but some issues naturally require decision making from the Chief Executive/Group Board. The Corporate Centre supports the Chief Executive in this decision making capacity and through overseeing governance and compliance with certain policies and procedures across the group. The Corporate Centre also provide centralised services such as treasury management, financial planning and human resources. Further details on services available to BUs and subsidiaries are provided in Annex A.

Governance in the Corporate Centre

In order that the Corporate Centre can operate across the ring-fenced businesses, CER and ESB developed the *Protocol on the Disclosure of Commercially Sensitive Information*¹³ to segment information in Corporate Centre through the provision of group services, and to control and contain information flow to the board, and the Chief Executive team who must be able to have full oversight of the Group positions to adequately discharge their duties. This is designed to be workable in the absence of full legal unbundling, which is not required by European law.

¹⁰ ESB Networks (2010) "DSO Compliance Report 2009"

<http://www.esb.ie/esbnetworks/en/downloads/DSO-Annual-Compliance-Report-2009.pdf>

¹¹ ESB Networks (2010) "Staff Compliance Code of Conduct"

<http://www.esb.ie/esbnetworks/en/downloads/Compliance-Code-of-Conduct-201009.pdf>

¹²S.I. No. 60/2005 — European Communities (Internal Market in Electricity) Regulations 2005

<http://www.irishstatutebook.ie/2005/en/si/0060.html#parti-article2>

¹³ CER (2006) "06/153 - ESB Protocol on the Disclosure of Commercially Sensitive Information"

<http://www.cer.ie/GetAttachment.aspx?id=520239a0-8393-4331-bb2d-86ec919fa2c8>

These arrangements are enforced through the ESB *Code of Business Ethics* which requires that “employees must comply with relevant legislation and licences” and stresses responsibilities regarding confidential information that are enforced as disciplinary matters.¹⁴ The *Protocol on the Disclosure of Commercially Sensitive Information* states that enforcement of any failure by ESB to comply with licence conditions, including ring-fencing requirements, can result in loss of a licence, addition of licence requirements and, where relevant, competition law challenges. Additional Trust and Confidence Agreements are used in certain cases to bind Executive Directors and the Group Support Management Team to these controls. We understand that these Trust and Confidence Agreements are used to reinforce measures where extra care must be taken on projects where there is access to commercially sensitive information relating to specific BUs. Outside of the Corporate Centre there is an example of these agreements being used within the Networks business where all staff involved in the Meter Registration System Operator activities must sign these agreements, supported by a CER-approved confidentiality policy.¹⁵

Individual responsibility to adhere to the governance arrangements is central to the functioning of this approach. Bad faith could of course undermine arrangements, but equally can destroy reputations and careers. The review team have not been made aware of evidence that the existing governance approach is insufficient. The Group Compliance Officer also has the duty to ensure the licence obligations are complied with and to report on compliance to the regulator. ESB also use an annually updated undertaking between their staff and procurement managers to declare any possible conflicts of interest and to maintain the confidentiality of information.¹⁶

Whilst CER does not regulate or ring-fence the ESB Corporate Centre, it is a crossroad for information in the group and therefore needs protections to avoid the cross-contamination or contravention of licence conditions. The *Protocol on the Disclosure of Commercially Sensitive Information* adds five specific supplementary measures to protect commercially sensitive information made available to the Corporate Centre:

1. **Briefing of ESB Board Members** – Requirements for the Secretary to inform Group Board Members of their responsibilities regarding commercially sensitive information given its impact within and outside the group.
2. **Communication between Corporate Centre Functions and licensed business** – Prohibition for the Corporate Centre to be involved in commercially-sensitive discussions or communications with ESB Customer Supply or ESB Power Generation where those discussions and communications concern both ESB Customer Supply, ESB Power Generation and/or other market participants, unless requested or approved to so by the CER.
3. **Classification of Documents** – Where information is provided to the Corporate Centre or the Board is commercially sensitive and should not be discussed or shared across business

¹⁴ ESB (2009) “ESB Employee Code of Business Ethics” pp4-5

http://www.esb.ie/main/downloads/about_esb/ethics.pdf

¹⁵ See ESB (2000) “ESB MRSO Confidentiality Policy”

http://www.mrso.ie/downloads/mrso_confidentiality_policy.pdf and

ESB (2003) “MRSO Trust & Confidence Agreement”

http://www.mrso.ie/downloads/mrso_confidentiality_agreement.pdf

¹⁶ ESB shared with the review team a titled “Undertaking to Declare Possible Conflict of Interest and Maintain Confidentiality of Information” on 0.9/06/11

units, it should be marked as Commercially Sensitive, and the restricted group it can be circulated to. It is the responsibility of the originating BU to ensure that their documents contain the appropriate captions.

4. **Dissemination of Documents** – The Company Secretary’s office is responsible to ensure compliance with the controlled circulation of ring fencing captions. Executive Directors not entitled to see the information may not participate in the agenda item at monthly Board meetings. Receivers of information in contravention of ring-fencing obligations must immediately delete/destroy the information, not use it for any purpose, and inform the sender, the Manager of Group Regulatory Compliance and the Head of Regulatory Affairs. The ESB Board’s compliance officer must detail these events in the Annual Compliance Report with further information provided to CER as required.
5. **Decision Making** – Commercial decisions should be made within the corresponding business units or in accordance with delegated authority levels.

These conditions are designed to cleanly funnel information up to the board and reduce the risk of inappropriate information leakage. We understand that CER and ESB are both content that the arrangements comply with EU and regulatory requirements. While the Protocol indirectly covers information from NIE, we assume that it is not enforceable in Northern Ireland. We consider that a similar arrangement for Northern Ireland would be helpful.

3.3 NIE specific arrangements

The ESB Board have received a note on their new licence obligations following the transaction, including on the transfer of information between licensed entities and on the requirement to act in the interest of customers in Northern Ireland (“*Note for incoming Board Members in relation to ring-fencing*” and “*Code of Business Conduct for ESB Board Members*”¹⁷). Other than the execution and implementation of new agreements, it is not clear that there are major changes in the way the Corporate Centre operates following the acquisition, or that they intend to divert from the intent of the Protocol in their dealings with NIE.

There are however, differences in the way NIE is governed compared to existing ESB subsidiaries that need to be accounted for in the Corporate Centre’s dealings with NIE and the other subsidiaries.

We understand that group services to NIE were previously provided by Viridian Corporate staff (who held contracts of employment with NIE), and strong conditions applied to those providing these services. Section B of the previous Compliance Plan under Viridian ownership¹⁸ required those providing group services to NIE to have had training on the relevant licence conditions, have enforceable clauses in their employment contracts and have time-limits before they can transfer to Associated Businesses. Those providing group services on legal and regulatory issues had tougher requirements, such that they were treated as “External Advisers”. Such requirements included prohibition of NIE’s engagement of any person who, at the same time or within the

¹⁷ ESB (2010) “Code of Business Conduct for ESB Board Members”

http://www.esb.ie/main/downloads/about_esb/Code-of-Business-Conduct-for-ESB-Board-Members.pdf

¹⁸ NIE (26th August 2009) “Compliance Plan” Section B

<http://www.nie.co.uk/customerinformation/pdf/NIE%20COMPLIANCE%20PLAN.pdf>

previous three months, was engaged by an Associated Business or Viridian on matters relating directly to supply or generation in the island of Ireland, where NIE's engagement of that person could give an Associated Business or Viridian an unfair commercial advantage. These conditions have remained in place under the Interim NIE Compliance Plan, submitted for approval on 21st December 2010. Any difference in these requirements on those giving these services as part of group services and those as part of the governance role detailed in the Memorandum of Understanding (at Appendix 2 of the Compliance Plan) must be clarified. The Utility Regulator is likely to need confidence that this can be complied with at ESB, or that new arrangements having equivalent outcomes can be negotiated.

The ESB Corporate Centre will also need to take account of the more stringent financial ring fencing arrangements for NIE. While NIE's financial ring fence conditions are not as stringent as Ofgem's or those that they are currently consulting on, the requirements they must comply with are more extensive than the Corporate Centre will have had experience with for ESBN to date.

3.4 Recommendation

We recommend that the Utility Regulator on behalf of the SEM Committee considers making equivalent arrangements to the CER's *Protocol on the Disclosure of Commercially Sensitive Information* with ESB to cover NIE and to ensure that NIE will have policies in place to comply with such arrangements. The Utility Regulator, with its legal advisers, will of course need to consider how best to adopt and enforce such a protocol.

4 AVAILABILITY OF RESOURCES

4.1 Context

This section considers obligations on NIE to disclose the availability of resources. This arises from a concern regarding financial ring-fencing, which has been a key plank of regulatory policy in many jurisdictions.

4.2 Requirements

It is clearly critical to NIE, its customers and the economy of Northern Ireland that NIE has the resources available to it to meet its licence conditions and to be able to invest in the significant planned growth of the network. Resources in this context mean financial and operational resources, including key managerial and operational staff.

Licence Condition 3 of NIE's licence relates to "Availability of Resource and Undertaking of Ultimate Controller." It requires NIE to provide an annual certificate that NIE has sufficient financial resources to carry on the Separate Business,¹⁹ together with a statement of the main factors taken into account in the giving of that certificate. We understand that NIE's external auditors currently provide a statement regarding the consistency of the certificate with the information available to them through their audit work.

The licence change consultation document suggests that the SEMC would like to see more of the thinking on the main factors supporting the statement and certificate, and suggests that this could be through a new Annex detailing the information used in coming to the conclusion. This suggests that the statement referenced above, in the context of ESB's market position, is not considered to be sufficiently detailed for the regulator.

As the Utility Regulator will be aware, Ofgem is currently consulting on ring fence conditions for network operators, and is proposing that the annual certification requirement should be extended to cover operational/ business resources and compliance status regarding key licence conditions. The requirement for an auditor's report on consistency between the annual certificate and the information the auditor obtained during work on the regulatory accounts would continue to apply to financial resources only. These new conditions would be made effective through changes to the licence itself.²⁰

4.3 Options to increase confidence

The Utility Regulator on behalf of the SEMC, acting in the interests of consumers, needs to strike a balance between an appropriate regulatory burden on the regulated company and its legitimate need to monitor compliance with licence conditions. As such, an annual certificate on availability of resources together with a supporting statement gives comfort to the regulator, whilst leaving the onus on company directors to confirm to their own satisfaction the basis of the given certificate and statement.

¹⁹ Northern Ireland Electricity plc, Participate in Transmission Licence, p37 defines Separate Business as each of the Transmission Owner Business, the Distribution Business and the Land Bank Business.

²⁰ Proposed Modifications to Ring Fence Conditions in Network Operator Licences, 25 March 2011, p16-17.

NIE's annual certificate currently refers only to financial resources. Extending it to operational resources makes sense as these are as important as financial resources if the company is to meet its obligations. For example, on the human resource side, the company would be confirming that it has in place succession plans for key managers and schemes to ensure availability of adequate engineering resource, and on the information technology side, the appropriate plans to secure that support to deliver key projects is in line with agreed outputs as well as a business continuity plan to cope with disruption caused, for example, through sabotage or acts of god.

The question is then whether the regulator relies on the certificate and statement or requires detailed supporting annexes. Such detailed annexes would most likely provide more in depth financial information (forecast P&L, balance sheet, cash flow and funding arrangements, say for the year ahead) and statements on non-financial resources. They would require some preparation from NIE, although all of the information would we expect already exist in NIE in different forms e.g. board papers.

It would be possible to continue to ask NIE's external auditors to confirm that the financial information in the annual statement is consistent with the audited accounts, although the auditor would be very reliant on statements from NIE management in coming to this view.

4.4 Recommendation

On balance, as we consider this would give more transparency to the key issue for the Utility Regulator, consumers and market entrants, we recommend that:

- As now, NIE provides an annual certificate and supporting statement confirming (or otherwise) that it has adequate resources to meet its plans in the year ahead.
- The certificate is broadened to cover business and operational resources, and the statement notes the main financial and operational factors considered in producing the certificate, including a twelve month cashflow forecast.

We see less value in the confirmatory statement from the external auditors, although if it can be provided at a reasonable cost it should continue. It would not be reasonable or of value to ask the external auditors to comment on operational resources for the year ahead or to audit aspects of the financial projections.

5 UNDERTAKING OF ULTIMATE CONTROLLER

This section addresses issues relating to the definition of NIE’s “Ultimate Controller.”

5.1 The Ultimate Controller

The Consultation Document notes that the ultimate controller undertaking should be broadened to ensure that the ultimate controller does nothing to prejudice the interests of consumers in Northern Ireland. We understand from ESB that it has already given an undertaking that it will, and to the extent possible procure that its subsidiaries will, refrain from any action that would be likely to cause NIE to breach its licence (or certain legislation applicable to NIE), as required under the existing NIE Licence Condition 3.

We note that ESB has already updated its *Directors Code of Conduct* with the wording “in discharging their duties as Board members of ESB, the Board will have due regard for the interests of consumers of electricity in Ireland and Northern Ireland.”²¹ It would be helpful to have the specific wording included in the NIE Licence, through an obligation to seek from the ultimate controller a statement that it will not prejudice the interests of consumers in Northern Ireland. This is a logical step to strengthen this justifiable requirement.

It could be argued that the ultimate controller should be the Irish government (and not ESB) as it is in a position to oblige ESB to follow a course of action that may breach licence obligations. We do, however, understand that this might cause legal difficulties such that ESB will of necessity be the ultimate controller. We understand that a similar issue arose when SONI was acquired by EirGrid, another regulated company owned by the government of the Republic of Ireland. This was solved by amending their licence to effectively treat EirGrid as the Ultimate Controller so long as they remained state-owned.²² We recommend similar arrangements should be put in place for the NIE licence unless there has been experience of problems with these arrangements in practice.

There is some value in NIE providing to the ESB Board an annual letter reminding ESB of its obligations towards NIE, given that the directors on the ESB Board can change from time to time and ESB directors have onerous duties to avoid obliging NIE to breach its licence.

5.2 Recommendation

We recommend that:

- the NIE licence be extended to require the Ultimate Controller statement to include a commitment not to prejudice the interests of consumers in Northern Ireland;
- ESB should be defined as Ultimate Controller, with similar licence provisions as used when SONI was acquired by EirGrid; and
- NIE be required to send a letter to the ESB Board each year to remind them of their commitments and responsibilities to NIE.

²¹ Code of Business Conduct for ESB Board Members, January 2011

²² See Licence Condition 3, paragraphs 10 and 11 of SONI’s SEM Operator Licence [http://www.uregni.gov.uk/uploads/publications/SONI - SEM Operator Licence - Consolidated Working Copy up to 12 March 2009.pdf](http://www.uregni.gov.uk/uploads/publications/SONI_-_SEM_Operator_Licence_-_Consolidated_Working_Copy_up_to_12_March_2009.pdf)

6 BOARD INDEPENDENCE

This section considers requirements on the independence of NIE's Board of Directors.

6.1 Role of parent and independent directors

Parent companies have a legitimate interest in the business strategy, performance, financing and governance of their subsidiaries. As such, it is relatively common practice for senior managers/group board directors from the parent company to sit on the subsidiary board, alongside independent directors and perhaps the Managing Director and Finance Director of the subsidiary.

Regulated networks have particular duties and obligations, as set out in their licences and in wider regulatory settlements. They also have monopolistic features and are a vital piece of national infrastructure, hence the concern from regulators to place additional obligations on them. This has primarily been through financial ring-fencing, but where they are subsidiaries there nonetheless remains a legitimate interaction with and interest from the parent.

No ESB Director or senior manager will sit on the NIE Board and so no NIE Board Director will be in communication with the group board(s) through board meetings²³. The former is in our view unusual, but makes the request from ESB for a 'joint' Company Secretary more understandable. ESB has set out the need for a person to undertake the 'corporate governance oversight role,'²⁴ with no voting rights, and that the ESB Board believes the ESB Group Company Secretary is the best person to play this role. This is understandable in light of the lack of a direct role on the NIE board. ESB has also stated that the Group Company Secretary will be able to act as a conduit for ensuring board regulatory compliance, and clarified that the role of the Company Secretary is an administrative one focused on governance arrangements and compliance, including board regulatory compliance, rather than a decision making role.²⁵ We also understand that NIE intends to continue with its own dedicated Company Secretary to fulfil the duties of the NIE Company Secretary. It is possible that in time NIE might wish to consider any efficiencies from outsourcing the Company Secretary role, but it seems unlikely to us that there would be significant savings that would outweigh the benefits of having an in-house Company Secretary.

We note that the ESB Chief Executive has the right to sit in on NIE Board and Board Committee meetings as an observer, which seems perfectly legitimate and proper. There is some concern as to whether ESB should be able to appoint an alternate observer. It is likely that in practice the ESB Chief Executive may not be able to attend all NIE board meetings due to other commitments and pressures, so an alternate is a reasonable suggestion. In our view the alternate should be from ESB Corporate Centre/ ESB Group Board, and could be potentially restricted to one or two named individuals, such as the Group Finance Director or the Group Regulation Manager.

²³ We do, however, understand that an ESB secondee may be on the NIE Board.

²⁴ Note regarding Joint Company Secretary, 31 March 2011

²⁵ See 'Note regarding Joint Company Secretary', ESB, 31 March 2011.

6.2 Flow of information from the NIE board to ESB

Under the arrangements proposed by ESB, information will flow from NIE board meetings to the ESB Corporate Centre and the ESB Group Board. The Compliance Plan allows for this. This will, in practice happen in a number of ways:

- Typically, the Group Company Secretary, in the 'joint' role, would be expected to receive the full set of NIE board papers. These would then be carried back to the ESB Corporate Centre for marking, in line with CER policy, as to confidentiality/ restrictions and filing.
- We would also expect that the Group Chief Executive, or alternate, as an observer, would also receive NIE board papers and that they would be handled as above.

It should be borne in mind that papers will also flow to ESB Corporate Centre on a less formal basis. Consider the following example. The Group Regulation Manager, as part of a legitimate interest in NIE's price control process and settlement, may take part in discussions with senior NIE management and receive draft papers. Those papers may potentially contain confidential or protected information, although the latter is perhaps less likely as the Group Regulation Manager is more likely to be involved at a strategic level. These papers would then be carried back to ESB Corporate Centre and would need filing in line with ESB and CER policies.

It is likely that similar interactions will/ do occur outside of the board meeting at the functional level. For example, ESB will provide advice for compliance with group policy/ practice in matters of Human Resources or Financial Reporting. This will include discussions and no doubt exchange of papers. Again, these papers would be treated in ESB Corporate Centre in the same way as NIE board papers.

6.3 Potential issues

The Utility Regulator, acting on behalf of the SEM Committee, has raised a specific concern regarding the role of the Group Company Secretary acting in a 'joint' capacity for the NIE board. The concern is that the Group Company Secretary may receive confidential information at the NIE board meeting, for example to do with investment in new transmission line, but, he/ she, as a matter of ESB Group policy will also attend other ESB subsidiary board meetings. At those meetings, the Group Company Secretary may be in attendance for discussions at which a generator is considering where to site a new investment, and it may be advantageous to know, in advance of competitors, the plans for NIE T&D. The concern is that the Group Company Secretary would be obliged to act in the interests of the generator, and feel pressure/ obligation to reveal confidential information.

In many respects, the example of the Group Regulation Manager in Section 6.2 raises similar issues to the above. For example, he/she may attend meetings at NIE, hear confidential or protected information, and subsequently attend meetings with ESB generation or supply subsidiaries. Again, is there an obligation or pressure to share confidential information with that subsidiary, if it would be in the interests of that subsidiary?

There are a number of potential safeguards against this risk:

- NIE compliance plan;
- conditions in employment contracts as required by the compliance plan;
- NIE policies on confidential information;
- ESB and CER policies as outlined above on:
 - safeguarding information; and
 - document handling;
- Staff member-specific trust and confidence agreements.

But these policies are only policies, and policies can always be breached, whether intentionally or not. At this point the personal integrity and individual behaviour of the manager in question is key. And on this point ESB has been at pains to point out that staff in the Corporate Centre, and the Group Company Secretary in particular, are people of good standing who have been selected into those positions because of their personal integrity and their ability to hold, whether in their heads or in papers, confidential information and to not disclose that information inappropriately. Furthermore, we have not been made aware of any individual breaches in relation to confidential or protected meetings.

Therefore, the best way to practically evidence that this issue is dealt with might be for:

- NIAUR to adopt a similar protocol to the *Protocol on the Disclosure of Commercially Sensitive Information* such that NIE's regulatory obligations are fully reflected in ESB's processes; and
- Directors/ Group Company Secretary/ staff from the ESB Corporate Centre attend NIE board meetings but leave the meeting for agenda items that are considered to contain potentially commercially sensitive and harmful information e.g. information that might give ESB or an Associated Business an unfair commercial advantage, and equally for ESB to agree to a protocol where its directors/group company secretary/staff from ESB corporate centre leave relevant ESB board meetings for items where their NIE knowledge is likely to cause a conflict of interest. How this would be monitored (i.e. through an NIE licence condition making this part of the ultimate controller undertaking or for example through ESB demonstrating practically that this was in place and being followed is a matter for the relevant parties to decide).

The latter would not, however, deal with less formal interactions, which would need to be governed by ESB/ NIAUR policies. It may be helpful for the NIE Board to periodically remind management and staff of their obligations to work according to those policies, perhaps on an annual basis, and to ensure that appropriate whistle-blowing channels are in place for management and staff.

6.4 Option for withdrawal from part of NIE board meetings

We understand that staff from the ESB Corporate Centre, including the ESB Company Secretary, are well used to dealing with information that is confidential from BU to BU, and that

there are a range of policies and procedures in place to ensure that confidential data is not used inappropriately.

Notwithstanding this, it might be an option for the NIE Company Secretary, in advance of board meetings, to identify those areas of the agenda where the subject matter is deemed confidential to NIE and outside of the scope of information that may be provided to any ESB Representative under the Compliance Plan. Then, at the relevant part of the agenda the ESB Company Secretary (and potentially the ESB Chief Executive, attending as an observer, or his/her alternate) would be asked to leave the meeting. The board minutes, which presumably would be prepared by the NIE Company Secretary, would record this. A full set of minutes would be maintained for NIE purposes, with ESB Corporate Centre being provided with a second set identical other than the fact that it would not contain any details regarding the particular NIE confidential items.

If desired by the SEMC, the Utility Regulator on behalf of the SEMC could monitor this through inspection of both sets of minutes from time to time, and could even be involved in identifying the broad subject matter that would fall into this category.

It is worth noting that such an approach would clearly not cover potential discussions/ meetings outside of formal board meetings. The conduct of such discussions/ meetings will of course ultimately rely on the integrity of the individuals involved, notwithstanding the range of policies, procedures and potential sanctions in place.

6.5 Recommendation

We recommend that:

- Given the agreed NIE board structure, it makes sense for the ESB Group Company Secretary to perform the proposed governance role with respect to NIE.
- The term 'Joint Company Secretary' is perhaps misleading, given that NIE will continue with its own Company Secretary. Consideration might be given to an alternate terminology, which makes it clear that the NIE Company Secretary is responsible for NIE matters, and that the ESB Company Secretary is performing a group governance role when attending NIE board meetings.
- The ESB Chief Executive should be able to appoint an alternate observer for NIE board meetings, but this observer should be from ESB Corporate Centre.
- NIAUR should adopt a similar protocol to the *Protocol on the Disclosure of Commercially Sensitive Information* (as also recommended in Chapter 3) such that NIE's regulatory obligations are fully reflected in ESB's processes;
- Directors/ Group Company Secretary/ staff from the ESB Corporate Centre attend NIE board meetings but leave the meeting for agenda items which are considered to contain potentially sensitive information e.g. information that might give ESB or an Associated Business an unfair commercial advantage. Equally, ESB to agree to a protocol where its directors/group company secretary/staff from ESB corporate centre leave

relevant ESB board meetings for items where their NIE knowledge is likely to cause a conflict of interest.

7 NETWORK INDEPENDENCE

This section considers the rationale for allowing interaction between NIE and ESBN and information flows more generally. We note that the draft Compliance Plan of 21 December 2010 allows for ESB Representatives to receive and access information about NIE in line with ESB's legal duties and obligations as the owner of NIE. This includes high level information on regulatory matters and financial information. The same draft Compliance Plan allows for the provision of Group Services and this aspect is discussed in Section 8 below.

We also understand from both the Utility Regulator and ESB that limited opportunities to share resources between NIE and ESBN have been pursued pending finalisation of licence changes and revisions to the Compliance Plan, and that there are no near term plans to share resources in any significant way, so there is no urgency from ESB's perspective to allow operational or managerial interactions between ESBN and NIE.

7.1 Associated business status

Condition 12 of NIE's licence requires "the full managerial and operational independence of the Transmission and Distribution Business from any Associated Business."

As currently defined in the licence, an "Associated Business" is:

*"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, the Transmission System Operator Business, the Market Operation Activity and Powerteam."*²⁶

We understand that as a subsidiary of an ultimate holding company of NIE, ESBN qualifies as an affiliate and therefore as an Associated Business. The provisions of Condition 12 are strong, precluding any interaction between the two networks.

Motivation to restrict interaction

Groups containing network companies and competitive elements up or down-stream of the network may benefit from giving their competitive elements an unfair advantage through:

- providing cross-subsidy to allow pricing below cost;
- managing the network in a manner that unfairly advantages group interests; or
- sharing "protected information" that the network has by virtue of its licensed activities to give a first-mover advantage unavailable to other market participants.²⁷

A good licence should preclude these anti-competitive practices. Cross-subsidy is prohibited through Licence Condition 5. Discriminatory behaviour is controlled by Licence Condition 15. The focus of requiring operational and managerial independence is the flow of information that could give an unfair advantage.

²⁶ NIE Licence Condition 12 definitions

²⁷ Protected information is defined in NIE's Licence Condition 10 as "information which is held or obtained by the Licensee (or any affiliate or related undertaking of the Licensee) pursuant to or by virtue of its carrying on of the Separate Businesses, but excluding information which is in, or comes into, the public domain other than as a result of any breach by the Licensee of this Licence (or any other legal obligation of the Licensee)."

Protected information is only harmful if it provides an unfair advantage in a competitive market. Therefore any information passed from NIE to ESNB should not in principle cause harm so long as it remains within the regulated network business. The regulatory judgement instead is whether provisions are in place to ensure that information cannot flow to companies in adjacent competitive industries and around the need for the Regulator to see the types of information that flows to validate that the ‘no harm’ situation remains valid.

Motivation to enable interaction

Associated Business status restricts the relationship and level of cooperation which is permitted between NIE and the Associated Business, in particular in light of the restrictions applicable to NIE with regard to Associated Businesses set out in Condition 12 of the Licence. In addition, Condition 10 of the Licence restricts the flow of information between NIE and other affiliates/related undertakings. Applying these restrictions in full to the relationship between NIE and ESNB would prohibit valuable interactions through working adjacently such as:

- collegiate sharing of information on best practice, as is often seen between GB networks operating in parallel; and
- shared response to storm damage.

In circumstances where these or other benefits can be realised, if “protected information” (as defined in the licence) can be suitably contained such that there is no harm to competition, it seems disproportionate to require full information independence of ESNB from NIE.

7.2 Managing information flow

Three main measures that are in place to prevent the flow of sensitive information are as below:

- Licence Condition 10 requires that, if any protected information flows from NIE to ESNB, as subsidiary of the relevant holding company, NIE would need to procure from ESNB that the information is not used for unfair commercial advantage, that it is not disclosed to other businesses without consent and that it would not create any unfair advantage.
- Measures to restrict protected information accessed by the Corporate Centre or Group Board flowing down to other Group companies.
- ESNB’s own ring-fence provisions prohibiting the communication of commercially sensitive information.

In addition, NIE has updated its policy on confidential and protected information post the acquisition by NIE to emphasise the need to protect and restrict certain information.^{28&29}

In our view, these conditions should be sufficient to protect the interests of consumers, with the caveat that the Utility Regulator should have access to the information flow. To increase

²⁸ NIE Ltd, Policy on confidential and protected information, January 2011

²⁹ In fact, this policy document may be unduly restrictive – on one reading it does not allow confidential information to be communicated outside NIE, whereas some confidential (but not protected) information will need to be passed to ESB to undertake its legitimate governance role.

regulatory confidence in these arrangements, targeted monitoring arrangements on the flow of protected information should be put in place. To achieve this, the Compliance Plan should include a requirement for each obligation in Licence Condition 12 to be allocated to a member of senior management, who is then responsible for the periodic sign-off of its requirements. NIAUR may also wish to request for notification from the Ultimate Controller of any complaints or reported breaches of relevant ring-fencing arrangements within the Group.

7.3 Options and recommendation

The current NIE licence reflects the Viridian structure where there were no other network businesses, therefore a default approach to restricting information flow was appropriate. It does seem, however, that there could be benefits to consumers in both Northern Ireland and Ireland from allowing NIE and ESBN to share information, so the question becomes what is the best option for this and what further safeguards should be put in place.

The first option is to rely on the strong conditions that are already in place to ensure that information shared between NIE and ESBN is not used for unfair advantage elsewhere, and to not designate ESBN as an Associated Business.

We understand, however, that the Utility Regulator has remaining concerns to ensure that assets and resources are not shared with ESBN as this potentially impacts on issues such as price control arrangements. As we also understand that as neither ESBN nor NIE have plans to share resources or assets, then the issues becomes one solely of information flow. As such the alternative approach is for ESBN to continue as an Associated Business, albeit with information flow between NIE and ESBN allowed. On balance, we support this alternative approach as we consider that it is a matter of regulatory judgement whether allowing NIE and ESBN to share assets or resources is consistent with NIE's licence.

Should the sharing of assets and resources be allowed or even encouraged (on efficiency grounds) in due course, then ESBN would need to be no longer designated an Associated Business and the onus will be on the NIE board to ensure that any interaction beyond information sharing is consistent with their licence, and that there should be no impairment on the regulator's ability to identify whether the fulfilment of Northern Ireland licence requirements is affected. Should such activities be allowed, we would expect detailed reporting through the Compliance Plan and any Regulatory Reporting Pack, such that the Utility Regulator (and CER) has transparency over levels and costs of services provided, and can review allowed revenues accordingly.

8 PROCUREMENT

As NIE has moved from one ring-fenced group providing internal corporate services to another, there have only been incremental changes to the shared services and procurement. The same requirements are in place to procure “on an arm’s length basis and on normal commercial terms,” and against cross-subsidy. The Draft Compliance Plan sets out a range of services that NIE may procure from ESB, namely finance, company services, human resources, safety, IT, pensions management, insurance services, legal and regulatory support. We understand, however, that this cannot generally happen unless there is evidence of competitive procurement having been undertaken to demonstrate value for money for all services, including corporate services. The main changes following the transaction are that:

- Viridian did not have an internal audit unit, whereas ESB Corporate can provide these services in-house;
- where there is potential for ESB to exercise buying power, testing for normal market conditions may not be sufficient to ensure that NIE are neither giving nor receiving cross-subsidy either through terms or quality of the procurement;
- as part of a much more complex group, there may be less transparency that NIE is receiving equal terms;
- the range of services: we understand that the quantum and potential impact of providing those services is much more wide ranging than that which existed under the Viridian group structure; and
- if not designated as an Associated Business, there are opportunities to jointly procure with ESBN – because there was no possibility of this in Viridian, this type of procurement is not yet reflected in the Compliance Plan.

The changes above may require some extra measures in the Compliance Plan to ensure they are fulfilled.

8.1 ESB procurement

ESB, should it be successful in competitive procurement, will be able to provide services for NIE through two routes:

- shared services parameterised by a Common Services Agreement (CSA); and
- Group-level procurement.

ESB Shared Services

NIE are in control of their demand for group services. ESB Shared Services are tightly defined in the Compliance Plan and must comply with the enforceable CSA.

The Corporate Centre provides both paid arms-length services and other non-discretionary services provided for governance purposes such as the Company Secretariat and Group Regulatory support which are paid for through a charge out mechanism. The largest difference in

shared services from the previous ownership model is that NIE will now have Group Internal Audit services available to them. ESB Group also has buying power in areas such as insurance and NIE can decide whether to opt in or to renew their existing arrangements when they expire. An agency agreement (based on transaction charges) is in place for ESB to provide treasury services (e.g. currency, managing surplus funds, debt portfolio management and raising securities). An allowance for this was provided for the former services at Viridian.

Licence condition 3 requires NIE to act in a manner to secure it has sufficient resources to carry on the business and fulfil its regulatory obligations. In this context, the NIE Board must satisfy itself on an ongoing basis that the outsourcing of essential functions, such as of treasury operations to the Corporate Centre, does not compromise the ability to fulfil these requirements. This may for example require that NIE retain the capability to source funds externally in the case of problems in the wider group. This same requirement applies to corporate services such as property and IT. The NIE board is and should always be accountable for the impact of its procurement decisions on the availability of resources.

We understand that Treasury Services is the only area where a CSA is currently in place between NIE and the Corporate Centre. Corporate Centre are also currently providing legal and regulatory support and have been provided monthly management reporting and year end accounts. NIE has been added to policy schedules for when insurance contracts are renewed.

Group level procurement

The following diagram shows ESB’s Procurement organisational structure.

Figure 8.1: ESB Procurement Organisation



Source: ESB presentation to CEPA 12/04/2011

As shown in Figure 8.1, each business in the group has its own independent procurement manager and team. However, above this level is the ESB Group Procurement Manager, who is responsible for policy, implementation of proper procedures, savings initiatives and reporting. ESB can also execute group purchases. Group procurement policy is set out in *Chief Executive Circular 4*³⁰ and each business has purchasing procedures approved by the Chief Executive.

³⁰ *Chief Executive Circular 4* is the ESB Group Procurement Policy. Selected details of ESB’s procurement policy are provided on the ESB Group website (<http://www.esb.ie/main/about-esb/procurement-policy.jsp>) and must comply with *The Code of Practice for the Governance of State Bodies* (<http://www.esb.ie/main/about-esb/procurement-policy.jsp>)

8.2 NIE procurement processes

NIE has experience of operating within a group where services are shared by multiple ring-fenced businesses. In particular, they have experience of having to work under licence requirements that procurement must be on an arm's-length basis, at market rates and without cross-subsidy. This covers shared services, financing and group procurement.

The NIE board will need to satisfy itself that NIE is not paying above market rates for any group services purchased, and this will be best demonstrated through market testing. In circumstances when it is considered by NIE economic to procure through the group, NIE will need to ensure that it is paying for services on the same basis as other group companies to ensure no cross-subsidisation. This could for example occur if NIE uses a group service but is restricted to a rate that they would receive on a standalone basis, allowing other group companies to receive the incremental benefit of NIE to any bulk discounts. It is a matter of regulatory judgement whether rates must be at cost, include a reasonable level of profit or none³¹ – the issue is that NIE must be able to ascertain that it is neither giving nor receiving a cross-subsidy through the costs incurred.

While NIE should be a competent judge of the relative value for money of using group, internal or external approaches, it is difficult to tightly enforce this condition as even small variations in quality or pricing tariffs can make direct comparisons invalid. Nonetheless this problem has not changed compared to arrangements before the transaction and the NIE Board remain responsible for choosing the appropriate level and arrangements for outsourcing for their business and to ensure it is consistent with all licence requirements.

Cross-subsidy

The more challenging judgement is the assessment of whether or not there is any variation in the terms of shared procurement such that NIE receives equal treatment to other companies. Two factors make this more difficult:

- NIE is now part of a much larger group, making evaluation of cross-subsidy more difficult; and
- cross-jurisdictional arrangements may require tailoring of quality between the two countries, further invalidating comparisons.

ESB would be in breach of its undertakings if it or any subsidiary provided services to NIE that caused it to give or receive any cross-subsidy, in contravention of Licence Condition 5. Consequentially, ESB should ensure accounting procedures are in place for any service provided to determine that no cross-subsidy has been given.

The Compliance Plan requires that:

³¹ Ofwat's transfer pricing guidelines require that "charges paid to the parent must be related to the services provided and should be charged at cost," with the onus on the appointee to demonstrate that the charges reflect costs incurred by the provider of the service. Ofwat (2005) "Guideline for transfer pricing in the water industry – Regulatory Accounting Guideline 5.04" http://www.ofwat.gov.uk/regulating/gud_rag_5transpric_504.pdf

“NIE will include a provision in the CSA which requires that in providing Group Common Services to NIE (and to any Associated Business) ESB will ensure that they are provided at rates which are reflective of the services being provided and which avoid cross-subsidies.”

NIE also may not enter a CSA that would likely put it in breach of its licence. NIE must be able to have sufficient information from ESB that this is the case and that it will continue to be so over time

Joint procurement

Given their parallel businesses, if ESBN is at some point no longer designated as an Associated Business, there may be synergies from pooling their buying power. In this case, they will need to be sure that they are providing a fair share of cost, including cost of executing the procurement.

The Compliance Plan only directly refers to cross-subsidy for common services. This Plan should be extended to ensure that it includes finance and other procurement items that fall outside any common services agreement. This would for example ensure that financing or insurance is on a basis such that NIE is able to actively benefit from scale if other subsidiaries also do so, whilst of course NIE must satisfy itself that rates incurred are no worse than market rates if it were to go directly to the market on a stand-alone basis. Licence Condition 5 should also be emphasised to those providing Group Common Services, alongside Condition 10 and 12.

For corporate insurance, there should be no particular concerns with ESB providing that insurance, providing it is on commercial terms, that NIE has no worse terms than any other ESB subsidiary and that ESB has the financial capacity to provide the maximum liability in the event of a claim. This of course assumes that NIE management will satisfy themselves that the provision of insurance is on no worse terms compared to third party provision.

8.3 Recommendation

Shared service activities currently represent a small portion of NIE spending and they have not yet taken part in ESB Group procurement activities. However, arrangements should be in place to ensure compliance with NIE’s licence, and consistency with the commitment from ESB not to put them in breach of their licence. We recommend that:

- the Compliance Plan should be extended to cover all group procurement including finance as well as shared services;
- the Compliance Plan should be adapted to be clear that NIE should not be allowed to access group procurement (common services and group procurement including finance) which incur costs unless it is possible to assess whether it is at a market rate and without cross-subsidy, assuming a market exists for those services;
- the Compliance Plan should require for common services to be market-tested regularly, say every three years, to ensure value for money;
- emphasis should be added to the Compliance Plan that people providing the relevant Group Common Services must comply with Condition 5 on cross-subsidy, just as Conditions 10 and 12 are currently highlighted; and

- the regulator may wish to see evidence in the Compliance Plan of which services are provided by the ESB Group and that these services have been obtained through a procurement exercise which demonstrably delivers best value to NIE, to help ensure compliance with the relevant licence obligations on these services. Note that we refer here to services which are paid for, rather than ESB Group policies which may be appropriate for NIE to adopt.

9 SUMMARY OF RECOMMENDATIONS

The acquisition of NIE moved NIE from one ring-fenced group to another, such that in general the regulatory threats that the system was designed to protect against are unchanged. But ESB is an integrated energy company and Viridian’s owner, Arcapita, was a financial investor, which has brought to light some new concerns. Many of these are dealt with by the existing regulatory arrangements. However, there are a number of areas where we recommend particular changes to the Licence and Compliance Plan in order to:

- appropriately update definitions in the Licence to reflect current circumstances;
- ease restrictions that are now unnecessarily broad in the new group structure; and
- bring some protections up to date.

Our recommendations are summarised in Table 9.1 below.

Table 9.1: Summary of recommendations

Topic	Recommendation
ESB Governance/ information flow	<ul style="list-style-type: none"> • We recommend that the Utility Regulator considers making equivalent arrangements to the CER Protocol on the Disclosure of Commercially Sensitive Information with ESB and to ensure that NIE will have policies in place to comply with such arrangements.
Availability of resources	<ul style="list-style-type: none"> • The certificate of the availability of resources should be broadened to cover business and operational resources, and note the main financial and operational factors considered in producing the certificate, including a twelve month cashflow forecast.
Undertaking of ultimate controller	<ul style="list-style-type: none"> • The NIE licence be extended to require the Ultimate Controller statement to include a commitment not to prejudice the interests of consumers in Northern Ireland. • ESB should be defined as Ultimate Controller, with similar licence provisions as used when SONI was acquired by EirGrid. • NIE be required to send a letter to the ESB Board each year to remind them of their commitments and responsibilities to NIE.
Board independence	<ul style="list-style-type: none"> • Given the agreed NIE board structure, it makes sense for the ESB Group Company Secretary to perform the proposed governance role with respect to NIE. • The term ‘Joint Company Secretary’ is perhaps misleading, given that NIE will continue with its own Company Secretary. Consideration might be given to an alternate terminology, which makes it clear that the NIE Company Secretary is responsible for NIE matters, and that the ESB Company Secretary is performing a group governance role when attending NIE board meetings. • The ESB Chief Executive should be able to appoint an alternate observer for NIE board meetings, but this observer should be from ESB Corporate Centre. <p>Consideration should be given to:</p> <ul style="list-style-type: none"> • Directors/ Group Company Secretary/ staff from the Corporate Centre attend NIE board meetings but leave the meeting for agenda items with are considered to contain potentially harmful information. Equally, ESB to agree to a protocol where its directors/group company secretary/staff from ESB corporate centre

	leave relevant ESB board meetings for items where their NIE knowledge is likely to cause a conflict of interest.
Network independence	<ul style="list-style-type: none"> • ESB to continue as an Associated Business, albeit with information flow between NIE and ESBN allowed.
Procurement	<ul style="list-style-type: none"> • The Compliance Plan should be extended to cover all group procurement as well as shared services. • The Compliance Plan should be adapted to be clear that NIE should not be allowed to access group procurement (common services and group procurement including finance) unless it is possible to assess whether it is at a market rate and without cross-subsidy. • The Compliance Plan should require for joint services to be market-tested regularly, say every three years, to ensure value for money. • Emphasis should be added to the Compliance Plan that people providing the relevant Group Common Services must comply with Condition 5 on cross-subsidy, just as Conditions 10 and 12 are currently highlighted. • The regulator may wish to see evidence in the Compliance Plan of which services are provided by the ESB Group and that these services have been obtained through a procurement exercise which demonstrably delivers best value to NIE, to help ensure compliance with the relevant licence obligations on these services. Note that we refer here to services which are paid for, rather than ESB Group policies which may be appropriate for NIE to adopt.

ANNEX A: ESB GROUP DESCRIPTION OF SERVICES

	Description	Examples	Pricing
Bought-in Works/ Supplies/ Services	<ul style="list-style-type: none"> • Procured from 3rd parties • Subject to competitive tendering in accordance with Authority Levels • Subject to requirement of Utilities Directive where value of contract exceeds threshold • 80/20 Rule applies to procurements from affiliates within the Group • Spend aggregated where feasible. All BU's/ subsidiaries can avail of benefits of bulk purchasing power. • Formal Purchase Orders placed 	<ul style="list-style-type: none"> • Framework Agreements for works/ supplies/ services <ul style="list-style-type: none"> ○ Consumables ○ Transport ○ Electrical equipment ○ Metering equipment ○ Contractors ○ Tools ○ PPE ○ IT ○ Travel ○ Mobile phone services ○ Wood poles ○ Chemicals ○ Etc 	<ul style="list-style-type: none"> • Each BU/Subsidiary places order and is invoiced separately by supplier • Lead Procurement Team costs shared by contract users
Business Services	<ul style="list-style-type: none"> • Internal Service Provider • Demand is driven by the user • Significant components outsourced e.g. Facilities • Centralised for efficiency reasons 	<ul style="list-style-type: none"> • Payroll • Supplier Payments • Vendor Master Set-Up • Standard recruitment campaigns • Facilities Management <ul style="list-style-type: none"> ○ Mail room ○ Management of outsourced cleaning, catering and security, reception ○ Archives ○ Contractor Management for outsourced 	<ul style="list-style-type: none"> • Service Level Agreements put in place with customer • Charged out at cost • ESB Networks Business Services costs reviewed as part of the Price control

	Description	Examples	Pricing
		<ul style="list-style-type: none"> building upkeep/maintenance e.g. lifts • IT <ul style="list-style-type: none"> ○ Network operations ○ IT Security ○ IT Helpdesk ○ Applications support ○ Disaster Recovery ○ Project Management 	
<p>Corporate Functions</p> <p>Including</p> <ul style="list-style-type: none"> • Offices of the Chief Executive, Deputy Chief Executive, Company Secretariat and Executive Directors Finance & Commercial and HR & Sustainability 	<ul style="list-style-type: none"> • Corporate activities • Provide support to the Board and Chief Executive of the Company • Not market provided functions • Tendering is not appropriate • Feature of all large companies • Networks company only allowed efficient costs for corporate functions as part of price control 	<ul style="list-style-type: none"> • Treasury <ul style="list-style-type: none"> ○ Treasury Management function ○ Bank/Investor relationship management ○ Raise funds from the market at market rates • Group Insurance <ul style="list-style-type: none"> ○ Responsible for managing group insurance risks and liabilities ○ Sources relevant policies to cover risks in the marketplace following competitive process • Group Internal Audit <ul style="list-style-type: none"> ○ In-house confidential internal audit function ○ Reports to Audit Committee of the Board ○ Prepare the Annual Audit Plan and conduct audits as appropriate ○ Sources external support where appropriate 	<ul style="list-style-type: none"> • Common Services Agreement (CSA) already in place for Treasury <ul style="list-style-type: none"> ○ Market rate for funds raised • CSA for Insurance in draft form <ul style="list-style-type: none"> ○ Pass through cost for premiums • Charge out formula for GIA • Provided subject to provisions of Ultimate Controller Undertakings (when in place).