

# **The Proposed Acquisition of Viridian Group PLC by ElectricInvest Acquisitions Limited**

**A Consultation Paper by the  
Northern Ireland Authority for Energy Regulation  
November 2006**

**Responses by 22 December 2006**

## **Summary**

The purpose of this paper is to consult on Ofreg's response to the proposed acquisition of the Viridian Group PLC ("Viridian") by ElectricInvest Acquisitions Limited ("ElectricInvest"). ElectricInvest is a holding company established for the purpose of this transaction owned by the investment bank Arcapita Bank B.SC ("Arcapita").

Ofreg is neutral as to the ownership of Viridian; we do not have powers to approve or prevent this takeover. However, we are determined to ensure that customers should not bear the cost of risks run by Arcapita or the wider Viridian group. This paper considers how risks could have an impact on regulated services to customers provided by NIE PLC (NIE), and how regulation can prevent this.

It therefore reviews the financial ring-fence already in place, asking whether the future regulation in this areas is proportionate.

This paper also considers changes to Viridian's and NIE's obligations to publish information that are likely as a result of the transaction, and consults on whether it would be appropriate enhance transparency by means of licence conditions. It also considers whether NIE's licence should impose further obligations relating to corporate governance.

This document also discusses the fact that Northern Ireland legislation does not currently provide protection in event the financial ring-fence were to fail. We suggest that a special administration regime should be created and consult on whether a supplier of last resort regime is needed.

1. Introduction .....	4
2. Background.....	6
3. Scope of Ofreg’s role .....	11
4. Regulatory Issues .....	16
5. Consultation questions .....	25
6. Annex A: Current ring-fence conditions .....	26
7. Annex B: Requirements on listed companies .....	35
8. Annex C: NIE Statutory accounts obligations .....	49

## 1. Introduction

1. On 6 October 2006, ElectricInvest, an acquisition vehicle for Arcapita, announced its offer to acquire Viridian.
2. Viridian is a company whose activities are at the heart of the Northern Ireland energy sector. It owns and operates our electricity networks; it is the contractual counter-party for most electricity customers and the majority of electricity generators; through regulated support schemes, it provides funding for renewables and the fight against fuel poverty; it is one of the prospective entrants into gas markets.
3. The proposed acquisition has naturally aroused considerable interest among observers and stakeholders in the Northern Ireland energy sector, including in relation to issues that do not fall within the scope of Ofreg's powers as economic regulator.
4. This consultation document raises issues arising from Ofreg's preliminary analysis of the proposed acquisition and its purpose is to consult on areas where, in the light of possible changes of circumstances arising from the proposed acquisition, changes in regulatory arrangements might be appropriate.
5. In this document:
  - Section 2 sets out the regulatory framework within which the Authority operates, and describes Viridian and the proposed acquisition by ElectricInvest;
  - Section 3 sets out the scope of Ofreg's involvement in this issue;
  - Section 4 sets out a number of policy and regulatory issues and our assessment of these issues;

- Section 5 requests relevant information and comments from all interested parties on the regulatory decisions facing the Authority.
- 6. Ofreg has no control over the timing of the acquisition process. We understand that shareholder meetings were held to vote on the proposal on 20<sup>th</sup> November, and that the proposed acquisition, via a Scheme of Arrangement, will be put to the Court in early December and, if approved, will become effective on 8<sup>th</sup> December. Ofreg wishes to be able to indicate its proposed courses of action, if any, promptly after the acquisition closes so they can be taken into account in any subsequent financial restructuring of Viridian. On this basis we currently plan to consult during December and reviewing responses in January. Our aim is to be in a position which would enable us to publish a position paper during January 2007. However, issues may emerge that require further consultation.
- 7. Responses to this consultation are therefore requested by 22 December
- 8. Responses should be sent to:

Tadhg O'Briain  
Ofreg  
Queens House  
14 Queen Street  
Belfast  
BT1 6ER

[tadhg.obriain@ofregni.gov.uk](mailto:tadhg.obriain@ofregni.gov.uk)

Unless specifically requested otherwise, responses may be published on our website. Respondents should clearly mark any part of their response (or, if appropriate, the whole response) they wish to remain confidential.

## 2. Background

### *Regulatory regime*

9. The Northern Ireland Authority for Energy Regulation (the Authority) was established by the Energy (Northern Ireland) Order 2003 as a non-Ministerial Government Department to regulate Northern Ireland's electricity and gas markets. The Authority is known as Ofreg for day-to-day business purposes.
10. Ofreg's principal objective as regards the electricity sector is to protect the interests of consumers of electricity, wherever appropriate by promoting effective competition. One of its primary duties is then to act in the manner best calculated to further the principal objective, having regard to the need to secure that licensees can finance their activities. Ofreg has regulated Viridian's regulated businesses on this premise since its inception, and will continue to do so into the future, regardless of any changes of ownership which may result from the proposed transaction or future transactions.
11. This means that price controls are and will be set using realistic financing assumptions, and on a basis that regulated businesses will make appropriate profits so long as they operate efficiently. The Authority has also sought to introduce appropriate incentives to improve efficiency which, in the short term, can lead to higher profits if the company performs well, while customers benefit from these arrangements over the longer term.
12. A key function of the Authority, by which it can achieve its principal objective to protect electricity consumers, is the publication of advice and information about regulated matters. The Authority may publish advice or information if it appears to the Authority that this would promote the interests of consumers in relation to electricity. However, the Authority must have regard to the need to exclude, as far as is practicable, material

whose publication might seriously or prejudicially affect the affairs of a company covered by publication. The Authority must also consult with such a company before publishing.

13. When publishing this consultation document, therefore, the Authority has been careful to exclude confidential information that might harm the commercial rights and interests of Viridian, ElectricInvest and Arcapita, with whom we have consulted prior to publication.

14. The Authority is committed to the Better Regulation Commission's Five Principles of Good Regulation: proportionality, accountability, consistency, transparency and targeting.

#### *About Viridian and the proposed acquisition*

15. On 6 October it was announced that Viridian's directors were recommending to shareholders an offer from ElectricInvest. This is an acquisition vehicle owned by Arcapita. The offer was to acquire the entire share capital of Viridian in exchange for 1,325 pence per share, plus an interim dividend of 11 pence per share. This values Viridian's existing share capital at £1.62 billion, a premium of 23% on the market valuation on the last day of trading prior to Viridian announcing that it was considering an offer, and a 37% premium on the average closing price over the last six months.

16. Viridian and Arcapita have indicated their intention to complete the acquisition process by means of an Scheme of Arrangement accepted by shareholders at a Court Meeting, and then at an Extraordinary General Meeting, and subsequently sanctioned by Court Order. Ofreg understands that the Court Meeting and EGM were held on 20th November 2006, and that it is hoped that the Scheme will become effective on 8th December 2006.

17. Viridian owns or operates a number of regulated businesses in Northern Ireland and in the Republic of Ireland. Viridian owns NIE, Viridian's major regulated subsidiary. This is a single regulated company, with a single licence document comprising a transmission licence and a public electricity supply licence which covers a number of separate activities, notably ownership and operation of networks and supply of electricity. Within NIE, therefore, there are a number of main divisions:

- NIE Infrastructure Division is responsible for the regulated transmission and distribution of electricity to around 775,000 homes and businesses in Northern Ireland and manages 45,000 km (28,000 miles) of network infrastructure. These transmission and distribution ("NIE T&D") activities are subject to a price control;
- NIE Supply provides electricity to the domestic and small business markets in Northern Ireland, and to some larger industrial or commercial customers. NIE is a Public Electricity Supplier ("NIE PES"), which means among other things that it is obliged to provide service to customers who request it. The domestic market in Northern Ireland is not expected to open to competition until mid-late 2007. As at March 2006, NIE Supply supplies around 760,000 customers. There is a separate price control for the PES business;
- NIE's Power Procurement Business ("NIE PPB") manages the legacy long term generation contracts with Ballylumford and Kilroot power stations in the interest of NI consumers. It also holds contracts with renewable generators for capacity secured under the Non Fossil Fuel Orders and manages the Land Bank including overseeing the decommissioning contracts at Belfast west and Coolkeeragh power stations.

18. NIE is also the transmission system operator in Northern Ireland through its subsidiary SONI Limited ("SONI"). SONI currently operates under the integrated NIE PLC licence. However, Ofreg expects SONI to be divested

by Viridian at some point over the next two years. Legislation to underpin the creation of the single electricity wholesale market between Northern Ireland and the Republic of Ireland is currently subject to consultation, and Ofreg understands this legislation will create a legal basis to require such divestment. To enable divestment, SONI's activity as transmission system operator will become separately licensed during 2007. Ofreg already sets a separate price control for SONI, and we expect to review this prior to divestment. Arcapita are aware of these regulatory intentions, and have informed Ofreg that they have no wish to contest their being carried out.

19. NIE also holds a gas licence to supply Ballylumford power station.
20. Viridian also owns Energia, a second tier supplier of electricity in Northern Ireland. Energia is the trade name for Viridian Energy Supply Limited, a subsidiary of Viridian Power and Energy Limited, and is subject to economic regulation by the Authority by dint of its holding a supply licence. Viridian Energy Supply Limited also holds a gas supply licence to supply gas to the Greater Belfast area.
21. Arcapita, formerly called First Islamic Bank, is headquartered in Bahrain and has offices in London and Atlanta<sup>1</sup>. It is an investment bank that aims to match investors (mainly in the Middle East) with international investment opportunities. Formed in 1996, it focuses its investments on corporate, real estate and asset-based investments, including a number of wind farm developments acquired in 2003 along with RWE. Arcapita has a large and diversified investor base of institutions and individuals.
22. Arcapita's ownership is diverse. Its management is the largest shareholder, with just over 19%; a range of Middle Eastern and Malaysian institutions and individuals hold the remaining shares.

---

<sup>1</sup> Information about Arcapita and ElectricInvest, and about their intentions following the acquisition of Viridian, has been provided by these companies and has not been independently verified by Ofreg.

23. Ofreg understands that Arcapita operates in line with the requirements of Sharia law, as well as other relevant legal requirements.

24. We understand that Arcapita, after its initial acquisition of Viridian, expects to sell indirect beneficial ownership of the majority of its investment on to investors, retaining only a small stake. It will however retain associated voting rights so as to retain control over 100% of the company. We are informed it has taken this approach in previous transactions.

### **3. Scope of Ofreg's role**

#### *Sectoral regulation*

25. Ofreg's main response to a change of control in a regulated company is to ensure that our ability to protect consumers is, at a minimum, not reduced. Where appropriate we will make proposals to enhance consumer protection, but bearing in mind that over-regulation is likely to be to consumers' detriment.
26. Ofreg's key concerns relate to diversification and risk. The risk profile of Viridian has already grown as it has increased the proportion of unregulated business within its portfolio (e.g., building generation and a non-price controlled supply business). However, Arcapita, as an investment bank, is very likely to have a wider range of exposures. Should these exposures create financial stress within the Arcapita group, it is important that the regulated businesses are not unduly affected.
27. Moreover, Ofreg understand that Viridian may undertake a higher level of debt to fund its activities after the transaction. The cost of debt – in particular, the rate available to regulated utilities – is currently relatively low by historical standards, and may be lower than the cost of equity. Arcapita may therefore be able to achieve significant savings by increasing the proportion of debt to equity in the Viridian finance package.
28. To some extent these pressures cancel each other out. In order to induce lenders to offer cheap debt to Viridian, Ofreg expects that Arcapita will need to put in place legal guarantees that protect Viridian from the effects of potential difficulties in the wider Arcapita group. Such protections are often backed up by surveillance by the financial institutions involved (for instance, by a monoline insurance company), and generally overseen by a rating agency.

29. There may be a range of opportunities (particularly in an integrating SEM, which is growing fast) for Viridian group to seek out higher risk/return opportunities in related markets and industries, using the relatively secure returns of the regulated company as security. A more highly geared financial structure could facilitate such expansion. In addition, higher debt levels (receiving more favourable tax treatment, and taking advantage of any equity-debt arbitrage opportunities that may currently exist) could in themselves generate savings for shareholders.

30. However, increasing gearing and intra-group diversification create not only profit opportunities, but also risk. Without appropriate protections NIE customers might participate in the risk without sharing the profits; and in any case, such a risk profile may not be appropriate for a utility providing vital services to society.

31. Ofreg's main goal in this situation is therefore to ensure that customers do not take on undue risk as a result of diversification (at the Arcapita level, but particularly intra-group). In practice, this has led us to consider in the following chapter measures that:

- Prevent the creation of "risk bridges" between the regulated business and the wider Viridian or Arcapita groups;
- Safeguard transparency so as to ensure that stakeholders and capital markets can continue to scrutinise the business, which might help Ofreg to identify potential problems as they arise;
- Would ensure "back-stop" provisions are in place should other safeguards fail.

32. Ofreg wishes to stress that no part of this paper should be taken as implying that we have any particular concerns about Arcapita as owner of NIE. The potential for Viridian to diversify into more risky but more profitable areas already exists, and as noted, to some extent Viridian is

already doing this. The potential for Viridian to increase its gearing substantially exists regardless of ownership. This is why many of the regulatory safeguards described in the following chapter already exist, and why we are consulting with an open mind on most of the proposals for extending regulation.

### *Precedents*

33. Ofreg is conscious that a significant body of regulatory lessons and good practice has evolved from similar corporate activity in the British utility markets. We will have regard to this good practice, as developed by Ofgem and Ofwat. In particular, this body of precedent has clarified the relationship between sectoral regulation and competition law, in the opinion of the European Commission concerning the merger of Electricite de France and London Electricity (merger case M1346). The Commission took the view that Ofgem had the right to take regulatory action, for instance to protect the financial position of the licensee and to ensure the adequate provision of information.

34. Ofreg's role, consistent with this body of precedent, is to ensure it can continue to meet its primary objective and carry out its functions in the new circumstances arising from a change of control.

35. As a matter of principle, Ofreg aims to put in place regulatory arrangements that are robust enough to operate effectively in a range of operating environments. Minimising the need for continual regulatory interventions is more efficient and also reduces regulatory risk.

### *Change of control approval*

36. Ofreg has no legal authority to intervene in or approve the proposed transaction. If the transaction had involved breaking up the regulated business, then this would have required regulatory permission; however,

this is not the case. There is no provision in the licences held by members of the Viridian group requiring regulatory approval for a change of control.

37. This state of affairs is consistent with GB precedent, and appears appropriate to Ofreg. We are not clear upon what basis we would carry out such an approval role. Ofreg does not regulate capital markets, although we do see the existence of a “market for corporate control” as broadly beneficial to customers, because it increases efficiency pressures on management.

38. Moreover, Ofreg does not have a general role to ensure that owners of regulated businesses are fit and proper persons for this role. While it may be reasonably feasible to identify the ultimate beneficial owners of a business (which owners would typically be businesses not individuals), it is much more difficult to establish the personal background of managers in owner-businesses, or whether the owners are themselves subject to significant influence. In particular, it would be difficult to discover information which such parties had an interest to hide. Ofreg does not have the investigative resources required to undertake such a role; and the very substantial amounts of money that would be required to carry out such investigations seem unlikely to be well-spent.

### *Valuation*

39. Ofreg has no view of the valuation placed on Viridian group as a whole by the bid. Our work to regulate the NIE businesses does not depend on the valuation placed on their parent group. Ofreg also has no direct role in relation to the compensation paid to management.

40. In our view, it is incorrect to extrapolate directly from the offered price for Viridian Group to a particular valuation of the regulated business, because the valuation will be based on a range of factors including the strength of Viridian’s management, the growth potential of the non-regulated

businesses within Viridian Group PLC, and the growth potential of the Irish market as a whole. Ofreg also recognises that the valuations placed on UK utilities in a number of recent bids or transactions have been seen by some commentators as high. For example, the independent gas distribution networks and a number of water companies have been acquired at premia to RAVs. There appears to be at present a particular appetite among investors for businesses delivering predictable cash flows within a transparent and stable environment, at a time when the stock of such businesses available to be bought is relatively restricted.

### *Competition*

41. Ofreg is the competition authority for Northern Ireland energy sector. However, like other sectoral regulators, Ofreg has no formal role in merger control. This role falls to the Office of Fair Trading (OFT). OFT have (as at 22<sup>nd</sup> November) indicated to us that they welcome our comments and views as Regulator on relevant aspects of the proposed acquisition. We remain of the view that the competition concerns arising from the transaction are likely to be small, but nevertheless welcome your views on any anti-competitive aspect of the proposed acquisition.
42. Ofreg understands that the proposed acquisition is subject to clearance by the Competition Authority in the Republic of Ireland, and that this was received on 15 November.

#### **4. Regulatory Issues**

43. As discussed in the previous section, Ofreg must ensure that our ability to protect customers is not diluted by changes arising in connection with the proposed change in ownership of Viridian Group. In particular, this means that any changes in financial structures within the Viridian group do not expose consumers in Northern Ireland to inappropriate risks or unwarranted price increases.

##### *Ring-fencing*

44. As part of its determination of the T&D price control for 2007-2012, Ofreg proposed improvements to the financial ring-fencing arrangements in NIE's licence. These broadly bring ring-fencing arrangements into line with those prevailing for Distribution Network Operators in Great Britain. The proposed licence conditions have been the subject of statutory consultation, and will be imposed in some form irrespective of the outcome of this consultation.

45. The purpose of financial ring-fencing conditions in the regulatory framework is to ensure that risks being run by owners of regulated businesses are not shared with the regulated entity. Financial ring-fencing requirements cover matters such as limits on indebtedness, maintaining sufficient financial resources and restrictions on business activity. Such conditions therefore reduce the likelihood of the regulated business being unable to finance its activities without otherwise unjustified price increases. The ring-fence conditions also impose tighter restrictions when the owner runs into financial stress (as signaled by the rating agencies).

46. These financial ring-fence conditions complement operational ring-fences, which limit the range of activities that regulated businesses can undertake and so prevent unduly risky diversification within the ring-fence.

47. The proposed modifications relate to the availability of resources and undertakings of the ultimate controller of NIE, restrictions on dividends, disposal of assets, indebtedness, and requirements relating to credit rating and gearing of the regulated entities. In particular, the proposals involve (inter alia):

- A prohibition on cross default guarantees: NIE PLC may not, without prior written consent from Ofreg, enter in agreements to make payments or repay debt because of a default by other persons, such as its holding company or affiliates of its holding company;
- A bar on disbursing funds without first ensuring the company can carry on the separate business and comply with its obligations under the Energy Order. Essentially this puts an obligation on NIE to ensure that will continue to be able to provide NI consumers with electricity. It cannot begin to take steps to wind down the company's operations. It also prevents NIE from guaranteeing to make payments (so-called upstream guarantees) to its holding company or its affiliates.
- A bar, without prior written consent from Ofreg, on borrowings or charges not:
  - a. For permitted purposes
  - b. On arm's length terms
  - c. On normal commercial terms

This amounts to a prohibition on setting up intra-group financial arrangements which disadvantage NIE and benefit its holding company. For example it cannot borrow from its holding company with an interest rate above what NIE would pay on the open market.

48. Additionally, one of the ring fencing provisions enables Ofreg to impose a requirement for NIE to maintain an investment grade credit rating. Ratings

agencies (S&P, Fitch, Moodys) specialise in the analysis of the ability of companies to meet their debt obligations. They therefore provide a useful early warning system for any difficulty that might arise threatening the financeability of regulated activities. If NIE is rated at the lowest investment grade and is on review for a downgrade or one of the agencies sees its outlook as negative, Ofreg can impose cash lock up conditions. That is to say, NIE would be expressly forbidden from transferring assets or cash from the regulated company; it would not be able to pay dividends to the holding company, or service loans which were not entered into on normal commercial terms.

49. These arrangements have been designed to reduce the risk of financial distress by constraining the conduct of the company, ensuring its resources are not diverted and that it is not exposed to undue risk. Their presence helps to reassure that NIE remains in a position to finance its functions and consumers' interests are not adversely affected by the company's capital structure.
50. Following the conclusion of Arcapita's take-over we expect a new financing structure to be put in place. Ofreg has the option to require NIE to acquire a formal credit rating and our current view is that the proposed conditions are sufficient. In any case, Ofreg expects NIE to maintain financial covenants which are consistent with an investment grade credit rating.
51. Should the review result in an unacceptable credit rating, however, we will consider what further action is required. It is worth noting that the rating agencies have gone on record that effective ring-fencing provisions have a positive impact on the ratings of utilities.
52. Ofreg invites views as to whether the current proposals for ringfencing are adequate, or whether further conditions are required to ensure that the

regulated business remains appropriately ringfenced from the activities of associated or holding companies.

*Undertakings from ultimate controller(s)*

53. If Arcapita's proposed acquisition of Viridian group proceeds, the active co-operation of the new owners will be necessary to ensure NIE PLC can properly carry out its functions. The ring-fencing proposals described above contain a proposed obligation on the "ultimate controller" of NIE PLC to provide a legally enforceable undertaking to refrain from any action that could cause the regulated business to breach its licence.

54. There is already a separate obligation (in the NIE consolidated licence, part IIB, Condition 6.1A) for the "holding company" to provide an undertaking to give the regulated business any information it needs to comply with its licence. This obligation should also apply after the acquisition, although minor modification may be needed to "refresh" this obligation.

55. In enforcing these obligations, Ofreg would seek to secure undertakings from both Viridian and Arcapita (and not from the special purpose vehicle ElectricInvest). The regulated entity will have a holding company and an ultimate controller, post acquisition. Ofreg takes the view that both Arcapita and Viridian should be required to provide both undertakings referred to above. These undertakings may also require minor modifications to achieve the desired effect. Collecting dual undertakings is not new to GB utility regulation and would appear to be commensurate with the situation in hand<sup>2</sup>.

56. Ofreg invites comments on the appropriateness of these undertakings; on whether the NIE consolidated licence, part IIB, Condition 6.1A needs to be

---

<sup>2</sup> See for instance Ofwat's June 2006 consultation paper "The completed acquisition of the Bristol Water Group PLC by Sociedad General de Aguas de Barcelona S.A. – A consultation paper by Ofwat".

modified so as to have full effect in the new situation; and on whether any additional undertakings should also be sought. As the provisions described above are in our view in line with common GB practice, respondents would need to describe clearly why additional undertakings would be appropriate in the NI situation.

### *Corporate governance*

57. At present there is no obligation on NIE to conform to best corporate practice, for instance by ensuring that a majority of the board are independent. There are precedents for regulators imposing such obligations following a change of control of a regulated utility, particularly where the regulated company was previously essentially independent. For example, Ofwat requires South Staffordshire Water, also ultimately controlled by Arcapita, to maintain three independent directors on its board. Such provisions strengthen confidence in the board maintaining the interests of the regulated company as its primary objective.

58. We ask for responses relating to the appropriateness including licence conditions regarding corporate governance and management, and specifically whether an obligation to have a set number of independent directors should be included in NIE licence.

### *Information issues*

59. Ofreg is concerned that the change in status of Viridian Group will reduce the amount of information available to the public about the regulated companies within it. However we understand that NIE PLC will remain a privately held public limited company (as now). A brief outline of the informational requirements imposed on listed companies is set out in Annex B. NIE's obligations relating to statutory and regulatory accounts, which will continue after the change in ownership, are set out in Annex C.

60. One way of ensuring maximum information flow for all stakeholders is to impose a licence condition to make the same information available as a listed company would. Specifically, Viridian's annual and interim financial accounts have until now contained segmental analysis which included NIE's financials, and a licence obligation could require that this information continue to be published.
61. Ofwat has imposed conditions of this type after previously listed companies were de-listed, for example when Arcapita acquired South Staffordshire Water.
62. The advantage of imposing obligations of this kind is that they extend the transparency of the company to a wide range of stakeholders, both customer representatives and those with a financial interest. This might lead to more extensive monitoring of the company which will complement Ofreg's own activities.
63. Set against this are potentially significant costs (which will ultimately be paid by customers). Given the significant transparency requirements that go with publicly listed debt, which Arcapita have indicated they intend to issue (although at the Viridian Group level), and which have a very substantial overlap with those of the existing equity listing, it may be that a licence condition on these lines would be superfluous.
64. Ofreg invites comments as to the appropriateness of such conditions for NIE PLC.

### *Special Administration Regime*

65. Although Ofreg does not consider the potential change in ownership of NIE, in itself, as increasing the risk of NIE insolvency, Arcapita's bid does

- provide an appropriate opportunity to consider whether a special administration regime should be introduced for energy networks in Northern Ireland.
66. Financial ring-fencing aims at reducing the likelihood of insolvency of the regulated entity by ensuring that the licensee is not exposed to inappropriate risks and that its financial resources are not diverted to other purposes. However, licence conditions cannot themselves deal with all risks – notably, risks that might arise from non-compliance with the licence – and they cannot therefore eliminate all possibility of insolvency.
67. The Energy Act 2004 introduced a special insolvency regime for licensed operators of electricity transmission and electricity and gas distribution networks, in GB. Special administration schemes also exist in the water and rail sectors in GB.
68. This special administration regime strengthens the protection offered to consumers if a network operator were to go into administration by placing a primary duty on an appointed special administrator to continue operations during the restructuring or transfer of the business. This regime therefore ensures that essential services continue to be delivered when a company becomes insolvent. The special administration provisions are complementary rather than alternative arrangements to financial ring-fencing provisions.
69. In the event of insolvency of an energy network company, the Energy Act 2004 allows the Secretary of State (or Ofgem, with the Secretary of State's consent) to apply to the High Court for an order to appoint a special administrator. This also enables the Secretary of State to disallow other forms of insolvency procedures if this endangers the security of supply in Britain. The overriding purpose of this special administration regime is to ensure the maintenance of safe and efficient delivery of gas

and electricity over the networks and that the company is rescued or transferred as a going concern.

70. In the absence of a special administration regime a receiver or administrator would be appointed under the Insolvency Act. He or she would owe duties to creditors simply to secure the highest distribution, for instance by obtaining the best possible price for the assets of the licensee.

71. Ofreg would support the creation of a special administration regime for energy in NI.

#### *Supplier of Last Resort (SoLR)*

72. Ofreg's principal objective is to protect the interests of consumers, wherever appropriate by promoting effective competition. In the event of a supplier failure, Ofreg's priority is to ensure that all customers continue to receive supplies of gas and/or electricity, and we would also aim to ensure such a supply is reasonably priced in all the circumstances.

73. However, there is currently no provision in the Electricity or Energy Orders for Ofreg to appoint a supplier of last resort. The NIE PES business is sometimes referred to as a "supplier of last resort" since customers have a right to return to the NIE PES from other suppliers, should they fail or otherwise become unappealing for the customer. However, this concept does not address the issue of what to do, should NIE PES itself become insolvent.

74. In GB, a regime exists whereby any supplier may be directed by Ofgem to act as SoLR in respect of the customers of an insolvent supplier. Where it is clear that the insolvent supplier will not be able to sell its customers through a trade sale, that supplier's licence is revoked and the customers of the failed supplier will be transferred to the SoLR selected by Ofgem.

The customers are served by the SoLR in the first instance under a “deemed contract”.

75. Electricity Directive 2003/54/EC provides that to ensure the provision of a universal service, member states may (but are not required to) appoint a supplier of last resort.

76. DETI consulted in 2005 on the implementation the electricity Directive. The Department concluded that the duty to supply which applies to the PES is equivalent to the SoLR regime as envisaged by the Directive. However the Department invited views on whether these arrangements would be sufficient in the event of supplier failure, for example through insolvency.

77. NIE, in its response to the consultation, indicated that it did not believe that the current PES arrangements are sufficient for a workable SoLR regime that protects customers in the event of supplier failure and that at a minimum the arrangements must provide a statutory basis for deemed contracts.

78. Ofreg does not consider that the Arcapita bid, in itself, creates any material additional risk of second-tier-supplier or PES insolvency. However, in Ofreg’s view the bid provides an appropriate opportunity to review whether a statutory basis for appointing a SoLR should be created.

79. Ofreg invites comments on whether it would be appropriate to create a legal basis for appointment of a supplier of last resort in the event of supplier insolvency.

## 5. Consultation questions

80. Are the current ring fencing and cash lock-up provisions sufficient to ensure that the financial position of the licensed undertaker does not reflect financial risks taken by other group entities? If not, what additional ring fencing provisions might be appropriate and what might be the costs and benefits of these?
81. Are existing obligations to provide ultimate-controller undertakings appropriate? Should any additional undertakings also be required?
82. Should Ofreg require NIE to provide information on the same basis as a listed company in addition to NIE's annual regulatory accounts and Viridian's accounts? Would other transparency obligations be appropriate?
83. Should Ofreg impose licence obligations relating to corporate governance and management, for instance requiring the majority of NIE's board to be independent non-executives?
84. Do respondents agree with Ofreg's position that the introduction of a special administrator regime for energy networks in Northern Ireland would significantly strengthen security of supply?
85. Do respondents believe the creation of a legal basis for appointment of a supplier of last resort in the event of supplier insolvency is appropriate?

## 6 Annex A: Current ring-fence proposals

**The following modifications are to be made to the Transmission and Public Electricity Supply Licences as granted to NIE in the form of a combined licence document on 31 March 1992**

### **Condition 3A of Part IIB**

Condition 3A shall be renamed and shall read Condition 3A: Availability of resources and undertaking of ultimate controller.

1. Paragraphs 1 through to 5 of Condition 3A shall be under the heading of Availability of Resources.
2. Paragraph 1 shall be reworded to read:
  1. The licensee shall at all times act in a manner calculated to secure that it has sufficient resources (including, without limitation, management resources, financial resources and financial facilities) to enable it to:
    - (a) *carry on the Separate Businesses; and*
    - (b) *comply with its obligations under the Order and the Energy Order and this licence.*
3. Paragraphs 6 through to 9 of Condition 3A shall be under the heading of Undertaking of ultimate controller.
4. Paragraphs 6 and 7 shall be reworded to read:
  6. The licensee shall procure from each company or other person which the licensee knows or reasonably should know is at any time an ultimate controller of the licensee a legally enforceable undertaking in favour of the licensee in a form specified by the Authority that that ultimate controller will refrain from any action, and will procure that every subsidiary of the holding company (other than the licensee and its subsidiaries) will refrain from any action, which would then be likely to cause the licensee to breach any of its obligations under the Order or the Energy Order or this licence. Such undertaking shall be obtained within 7 days after the date when these modifications become effective, or after the person in question becomes an ultimate controller (as the case may be) and shall remain in force for as long as the licensee remains the holder of this licence and the giver of the undertaking remains an ultimate controller of the licensee.
  7. The licensee shall:

- (a) deliver to the Authority evidence (including a copy of each such undertaking) that the licensee has complied with the obligation to procure undertakings pursuant to paragraph 6;
  - (b) inform the Authority immediately in writing if the directors of the licensee become aware that the undertaking has ceased to be legally enforceable or that its terms have been breached; and
  - (c) comply with any direction from the Authority to enforce any such undertaking.
5. In Condition 3A of Part IIB, the following new paragraphs 8 and 9 shall be inserted immediately after existing paragraph 7 –

8. The licensee shall not, save with the written consent of the Authority, enter (directly or indirectly) into any agreement or arrangement with an ultimate controller of the licensee or any of its subsidiaries (other than the subsidiaries of the licensee) at a time when:

- (i) an undertaking complying with paragraph 6 is not in place in relation to that ultimate controller; or
- (ii) there is an unremedied breach of such undertaking; or
- (iii) the licensee is in breach of the terms of any direction issued by the Authority under paragraph 7.

9. In this Condition 3A, unless the context otherwise requires, “ultimate controller” means:

- a. any holding company of the Licensee, which is not itself a subsidiary of another company; and/or*
- b. any person who (whether alone or with a person or persons connected with him) is in a position to control, or to exercise significant influence over, the policy of the licensee, or any holding company of the licensee, by virtue of:*
  - i. rights under contractual arrangements to which he is a party or of which he is a beneficiary;
  - ii. rights of ownership (including rights attached to or deriving from securities or rights under a trust) which are held by him or of which he is a beneficiary,

but shall exclude any director or employee of a corporate body in his capacity as such and any minister, ministry, department, agency, authority, official or statutory person;

and a person shall be considered to be connected with another person if he is party to any arrangement regarding the exercise of any such rights as are described in paragraph (b) above.

### **Condition 3B of Part IIB**

In Part II B, a new Condition, Condition 3B: Restriction on Dividends shall be inserted.

#### Condition 3B: Restriction on Dividends

1. The directors of the licensee shall not declare or recommend a dividend, and the licensee shall not make any other form of distribution within the meaning of Article 271 of the Companies (Northern Ireland) Order 1986, or redeem or repurchase any share capital of the licensee, unless prior to the declaration, recommendation or making of the distribution (as the case may be) the licensee has issued to the Authority a certificate in the following form:

“After making enquiries, the directors of the licensee are satisfied:

- (a) that the licensee is in compliance in all material respects with all the obligations imposed on it by conditions 3A, 4, 6, 8 and 8A of Part II B and condition 20 of Part II G of its licence; and
  - (b) that the making of a distribution of [ ] on [ ] will not, either alone or when taken together with other circumstances reasonably foreseeable at the date of this certificate, cause the licensee to be in breach to a material extent of any of those obligations in the future.”
2. The certificate given under paragraph 1 must be signed by a director of the licensee and must have been approved by a resolution of the board of directors of the licensee passed not more than 14 days before the date on which the declaration, recommendation or payment in question will be made.

3. Where the certificate given under paragraph 1 has been issued in respect of the declaration or recommendation of a dividend, the licensee shall be under no obligation to issue a further certificate prior to payment of that dividend, provided that such payment is made within six months of the issuing of that certificate.

### **Condition 8 of Part IIB**

1. Condition 8: Disposal of relevant assets shall be modified to read:

Condition 8: Disposal of relevant assets and Indebtedness.

2. Paragraphs 1 to 4 of Condition 8 shall be under the heading of Disposal of relevant assets.

3. Paragraphs 5 to 8 of Condition 8 shall be under the heading of Indebtedness.

4. In paragraph 5, part (a) shall be reworded to read:

*a. create or permit to remain in effect any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or enter into any guarantee of any obligation otherwise than:*

- i. on an arm's length basis;
- ii. on normal commercial terms;
- iii. for a Permitted Purpose; and
- iv. (if the transaction is within the ambit of paragraph 1) in accordance with paragraphs 3 and 4.

5. In paragraph 5, part (b) (iv), (v), (vi), (vii), (viii) and (ix) shall be reworded to read:

- iv. a transfer, lease, licence or loan of any asset, right or benefit on an arm's length basis and on normal commercial terms and made in compliance with the payment requirement referred to in paragraph 6;
- v. repayment of any loan or payment of any interest on a loan not prohibited by sub-paragraph (a);
- vi. payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received;

- vii. a transfer for the purpose of satisfying paragraph 10 of Part II Condition 20;
- viii. an acquisition of shares in conformity with paragraph 9 of Part II Condition 20; or
- ix. a loan to any affiliate or related undertaking of the licensee, which is made for a Permitted Purpose, provided, however, that paragraph 7 of Condition 8A of Part II B shall prevail where that paragraph applies;

6. The following new sub paragraphs (c) and (d) shall be inserted immediately after existing paragraph 5(b):

- (c) enter into an agreement or incur a commitment incorporating a cross-default obligation; or
- (d) save for the Northern Ireland Power Project Finance Contract made between European Investment Bank and Northern Ireland Electricity plc on 16 December 1999, continue, or permit to remain in effect, any agreement or commitment incorporating a cross-default obligation subsisting at the date this paragraph 5(d) takes effect, save that the licensee may permit any cross-default obligation in existence at that date to remain in effect for a period not exceeding twelve months from that date, provided that the cross-default obligation is solely referable to an instrument relating to the provision of a loan or other financial facilities granted prior to that date and the terms on which those facilities have been made available as subsisting on that date are not varied or otherwise made more onerous,

provided, however, that the provisions of sub-paragraphs (c) and (d) shall not prevent the licensee from giving any guarantee permitted by and compliant with the requirements of sub-paragraph (a).

7. Paragraph 6 shall be replaced by the following paragraph:

6. The payment requirement referred to in paragraph 5(b)(iv) is that the consideration due in respect of the transfer, lease, licence or loan of the asset, good, right or benefit in question is paid in full prior to such transfer, lease, licence or loan unless:

- (a) the counter-party to the transaction has, and maintains until payment is made in full, an investment grade credit rating; or

- (b) the obligations of the counter-party to the transaction are fully and unconditionally guaranteed throughout the period during which any part of the consideration remains outstanding by a guarantor which has and maintains an investment grade credit rating.
8. In paragraph 8, the following definitions shall be inserted in alphabetic order:

**“cross-default obligation”** means a term of any agreement or arrangement whereby the licensee’s liability to pay or repay any debt or other sum arises or is increased or accelerated or could reasonably be expected to be capable of arising, increasing or of being accelerated by reason of a default (howsoever such default may be described or defined) by any person other than the licensee, unless:

(a) that liability can arise only as a result of a default by a subsidiary of the licensee;

(b) the licensee holds a majority of the voting rights in that subsidiary and has the right to appoint or remove a majority of its board of directors; and

(c) that subsidiary carries on business solely for the purposes of a Permitted Purpose (but not a purpose identified in sub-paragraph (f), (g) or (h) of the definition of Permitted Purpose);

**“indebtedness”** means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection herewith

**“investment grade credit rating”** has the meaning given to that expression in Condition 8A of Part II B

## Condition 8A of Part IIB

A new Condition shall be inserted immediately after Condition 8 of Part IIB, and shall read as:

### **Condition 8A: Financial gearing and credit rating**

4. The licensee shall, within 14 days of this Condition 8A taking effect and thereafter by 30 June of each year, submit to the Authority a certificate, approved by a resolution of the board of directors of the licensee and signed by a director of the licensee pursuant to that resolution, showing the Financial Gearing as at the end of the preceding Financial Year. The licensee shall provide the Authority with such information to support that certificate as the Authority may request.
5. For the purposes of paragraph 1:

<b>“Financial Gearing”</b>	means Net Debt as a percentage of the regulatory asset base of the Transmission and Distribution Business such regulatory asset base being equivalent to the value of the term $CRAB_t$ as calculated in accordance with Schedule 4. ;
<b>“Net Debt”</b>	means the licensee’s total borrowings (including bank loans, debt securities, finance leases, hire purchase contracts and non-equity shares) less the licensee’s cash and cash equivalents.

6. The following paragraphs of this condition shall only apply where the Authority has issued a direction stating that they are to apply, and shall cease to apply on the expiry of any period specified for such purpose in that direction or on the Authority directing that they are no longer to apply.
7. The licensee shall take all appropriate steps to ensure that the licensee obtains and thereafter maintains an investment grade credit rating.
8. In this condition, an “investment grade credit rating” means:
  - (a) *unless sub-paragraph (b) below applies:*
    - (i) an issuer rating of not less than BBB- by Standard & Poor’s Ratings Group or any of its subsidiaries;

- (ii) an issuer rating of not less than Baa3 by Moody's Investors Service Inc. or any of its subsidiaries;
  - (iii) an issuer senior unsecured debt rating of not less than BBB- by Fitch Ratings Ltd or any of its subsidiaries; or
  - (iv) an equivalent rating from any other reputable credit rating agency which, in the opinion of the Authority, notified in writing to the licensee, has comparable standing in both the United Kingdom and the United States of America; or
- (b) *such higher rating as may be specified by those agencies from time to time as the lowest investment grade credit rating.*
9. Paragraph 7 shall apply if at any time which is not less than 4 months after the Authority has issued the direction referred to in paragraph 3:
- (a) *the licensee does not hold an investment grade credit rating;*
  - (b) *where the licensee has a rating with more than one of the rating agencies referred to in paragraph 5, one or more of the ratings held is below those referred to in paragraph 5; or*
  - (c) *the licensee has one of the ratings referred to in paragraph 5 and:*
    - (i) is on review for possible downgrade; or
    - (ii) the rating outlook of the licensee as specified by one or more of the credit rating agencies referred to in paragraph 5 has been changed from stable or positive to negative.
10. Where paragraph 6 applies, the licensee may not without the prior written consent of the Authority (following disclosure of all material facts) transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate or related undertaking of the licensee as described or referred to in paragraph 5(b) of Condition 8 of Part II B, otherwise than by way of:
- (a) *payment properly due for any goods, services or assets in relation to commitments entered into prior to the date on which the circumstances described in paragraph 6 arise, and which are provided on an arm's length basis and on normal commercial terms;*
  - (b) *a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and where the value of the consideration due in respect of the transaction in question is payable wholly in cash and is paid in full when the transaction is entered into;*

- (c) *repayment of, or payment of interest on, a loan not prohibited by paragraph 5(a) of Condition 8 of Part II B and which was contracted prior to the date on which the circumstances in paragraph 6 arise, provided that such payment is not made earlier than the original due date for payment in accordance with its terms; and*
- (d) *payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received, provided that the payments are not made before the date on which the amounts of tax thereby relieved would otherwise have been due.*

## **7 Annex B: Requirements on listed companies**

Arcapita provided Ofreg with a list of some of the more important disclosure requirements currently applying to Viridian as a listed company or as a PLC but which will cease to apply following the takeover and the conversion of Viridian Group PLC from a public company to a private company. These are set out below. A full statement of the obligations of listed companies can be found on the FSA website ([www.fsa.gov.uk](http://www.fsa.gov.uk)).

### *Listing Rule 7: listing principles*

- A listed company must take reasonable steps to enable its directors to understand their responsibilities and obligations as directors.
- A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.
- A listed company must act with integrity towards holders and potential holders of its listed equity securities.
- A listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuance of a false market in such listed equity securities.
- A listed company must ensure that it treats all holders of the same class of its listed equity securities that are in the same position equally in respect of the rights attaching to such listed equity securities.
- A listed company must deal with the FSA in an open and co-operative manner.

### *Listing Rule 9: continuing obligations*

- Meet certain eligibility requirements on a continuing basis in order to remain listed.
- Adhere to certain continuing obligations as regards holders of securities.
- Submit certain documents to its shareholders for prior approval (for example, employee share schemes, long-term incentive plans and discounted option arrangements).
- Adhere to rules relating to specific types of equity transactions, such as rights issues and the 10% discount and fractional entitlement rules.
- Notify changes in major shareholdings, lock-ups and shareholder resolutions passed by the company other than resolutions concerning ordinary business passed at an annual general meeting.
- Publish preliminary statements of annual results and dividends.
- Publish an annual report and accounts.
- Publish half-yearly reports (interim results).

*Listing Rule 10: significant transactions*

- Rules for transactions by a listed company whereby the company is required to classify the transaction and dependant on the classification the company may be required to make an announcement, publish a circular to its shareholders and obtain shareholder approval.

*Listing Rule 11: related party transactions*

*Listing Rule 12: dealing in own securities and treasury shares.*

*Listing Rule 17: Debt and specialist obligations*

- Publish annual report and annual accounts within 6 months of the end of the financial period to which they relate.

- Notify a RIS as soon as possible of, inter alia, (i) any new issues (ii) change in the rights attaching to listed securities (iii) change to paying agent (iv) publication of annual report and accounts.
- In each EEA state ensure that all necessary facilities and information are available to enable holders of securities to exercise their rights, including publishing notices or distribute circulars giving information on payment of interest and repayment of securities.
- Notify a RIS of all notices to holders of listed securities.
- Submit to FSA draft copy of any proposed amendment to constitution which would affect the rights of the holders.

Following the takeover and conversion, the disclosure obligations contained in the following rules will cease to apply to Viridain, but will continue to apply to Northern Ireland Electricity PLC (a subsidiary of Viridian) as a result of its £175,000,000 6.875% bonds due 2018 which are listed on the London Stock Exchange:

*Disclosure Rule 1: Introduction*

- Issuer must provide to FSA as soon as possible following a request and provide any information the FSA considers appropriate to protect or ensure the smooth operation of the market and verify whether the disclosure rules are being complied with
- Issuer must take all reasonable care to ensure that any information it notifies to Regulatory Information Service (RIS) is not misleading, false or deceptive

*Disclosure Rule 2: Disclosure and control of outside information by issuers*

- Issuer must notify a RIS of any inside information relating directly to it as soon as possible.
- Establish effective arrangement to deny access to inside information to persons other than those who require it
- Draw up insider list of persons who have access to inside information and provide it to the FSA.

*Disclosure Rule 3: Transactions by persons discharging managerial responsibilities and their connected persons*

- Issuer must notify a RIS of any information notified to it by a person discharging managerial responsibilities and their connected persons of transactions conducted on their own account in the shares of the issuer

*Prospectus Rule 5.2: Annual Information update*

- Annually prepare and notify to a RIS a document that refers to or contains all information that has been published or made available to the public over the previous 12 months in one or more EEA states and in third countries.

## **Annex C NIE Statutory accounts obligations**

NIE statutory accounts are prepared in accordance with the relevant company legislation and contain all the necessary disclosures required under international accounting standards and company law. NIE's annual report must be prepared in accordance with Article 242ZZB of the Companies (Northern Ireland) Order 1986 which requires the annual report to include:

- a fair review of the development and performance of the company's business and of its position;
- a description of principal risks and uncertainties that it faces including, to the extent necessary, both financial and, where appropriate, relevant non-financial key performance indicators.

Under Article 242ZZB of Companies (Northern Ireland) Order 1986 :-

1. The directors' report for a financial year must contain:

- (a) a fair review of the business of the company; and
- (b) a description of the principal risks and uncertainties facing the company.

2. The review required is a balanced and comprehensive analysis of:

- (a) the development and performance of the business of the company during the financial year; and
- (b) the position of the company at the end of that year,

consistent with the size and complexity of the business.

3. The review must, to the extent necessary for an understanding of the development, performance or position of the business of the company, include:
  - (a) analysis using financial key performance indicators; and
  - (b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.
4. The review must, where appropriate, include references to, and additional explanations of, amounts included in the annual accounts of the company.
5. In this Article, “key performance indicators” means factors by reference to which the development, performance or position of the business of the company can be measured effectively.
6. In relation to a group directors’ report, this Article has effect as if the references to the company were references to the company and its subsidiary undertakings included in the consolidation.