

# Agency Governance – Detailed Proposals

Network Sales

DISG 16 – 17 August 2004

# Contents

- **Non-executive Director selection, role, and remuneration (3 & 4)**
- **Voting rights and decision making (5 – 8)**
- **Allocation of Directorships (9)**
- **Future changes in DN ownership (10)**

# Selection of the non-executive Director

- Criteria and experience for selection. Commercial decision for owners but :
  - Requires demonstration of relevant knowledge and management track record, but not necessarily connected with gas/utility industry
  - External advert for position will mention that experience of the perspective of a service recipient, possibly a service provider to a shipper, may be advantageous
  - Coach for Board behaviour and experience of corporate governance
  - Cannot currently be working for any GT or customer of xoserve
- Process for appointment:
  - Once future shareholders have been identified (post purchase agreement signing) they will be asked to agree a process for external recruitment and for nominations
  - This group will agree a shortlist of candidates
  - Non-executive appointed at first shareholder's meeting, based on special majority voting
  - Role and individual reviewed on an annual basis by shareholders meeting

# Non-executive Director's role and remuneration

- Role:
  - The non-executive will chair the board :
    - Long term continuity for board, avoiding rotation
    - Concentrates on process and coaching role, driving the correct behaviours
  - Does not represent a shareholder and therefore has no voting rights – focus is on process, good corporate governance and driving co-operative decision making
  - 20 days per annum commitment made up of:
    - 8 days for quarterly Board meetings
    - 1 day per month acting as Chairman (xoserve representative) with stakeholders
- Payment and funding:
  - Market median : fixed annual payment of £20,000 plus expenses, reviewed annually
  - One year rolling contract (to incentivise independent behaviour)
  - Initially for 20 days per year commitment
  - Funded by xoserve (and hence part of xoserve's costs) as a normal cost of doing business

# Classification of voting rights under the Agency shareholder agreement

- Voting rights are divided into four categories:
  - Simple majority – for all decisions except as defined in Schedule 3, cast by Directors based on one vote per network owned (i.e. ( votes in total : 8 distribution networks, 1 transmission network)
  - Special majority of the Directors – Requires the nominated Directors appointed by not less than 3 independent shareholders<sup>1</sup> cumulatively holding at least 50% of voting shares (effectively NGT + 2)
  - Written consent of not less than 3 shareholders<sup>1</sup> –Requires the written consent of not less than 3 independent shareholders<sup>1</sup> cumulatively holding at least 50% of voting shares
  - Unanimity – written consent of all shareholders
- The rules for special majority voting are subject to the number of independent shareholders<sup>1</sup> created by the network sales process, variations are described below

<sup>1</sup> Special majority requirements apply to non-affiliated, or independent, shareholders (e.g. each of the three shareholders required for a special majority decision must be part of an independent group of companies)

# Special majority voting rights

- Items requiring special majority votes and unanimous votes are defined in the attached Schedule 3
- Changing the decisions requiring special majority and unanimous votes places the same requirement on all parties:
  - Schedule 3 updates will be subject to the same requirements as any other amendments to the shareholders agreement – written consent of all parties
  - Hence a minority party has the right of veto and cannot carry an amendment without the consent of all other shareholders – exactly the same rights afforded to all parties

# Further controls on decision making

- Avoiding Transco exerting undue influence in decision making:
  - Special majority decisions mean Transco cannot take important decisions unilaterally
  - Independent non-exec introduces another control and layer of governance
  - Major modifications to services and systems will be mandated by the UNC modifications panel process, UK Link committee and Ofgem; xoserve make decisions on how to execute these, not whether they go ahead
  - All parties still have recourse to Ofgem and Ofgem retain powers through GT licences
- Avoiding deadlock in decision making:
  - The majority of decisions will be made by the simple, quick and decisive majority voting of the Directors
  - Special majority stops a single minority party causing deadlock by avoiding the need for unanimity
  - Independent non-exec has role in coaching all Board members and encouraging functional decision making

# Special majority stress testing

- Special majority voting is designed to balance:
  - Stopping abuse of power by majority shareholder (e.g. Transco)
  - Avoiding deadlock in decision making process
- Balancing these objectives is dependant on the number of independent shareholders<sup>1</sup> created by the network sales process:

Number of independent shareholders <sup>1</sup>	Shareholders required to pass special majority <sup>2</sup>	Rationale
2	2	There are only 2 shareholders, therefore special majority could only be by 2 - effectively a unanimous decision
3	2	Moving to a requirement of 3 shareholders would create the requirement for a unanimous decision – increasing the risk of deadlock
4	2	Moving to a requirement of 3 shareholders makes it difficult to get a decision – increasing the risk of deadlock
5	3	As per new proposal discussed previously at DISG

<sup>1</sup> Special majority requirements apply to non-affiliated, or independent, shareholders (e.g. each independent shareholder must be part of an independent group of companies)

<sup>2</sup> In all cases these shareholders must also hold at least 50% of the shares to pass a special majority decision



# Allocation of Directorships

- The current shareholder's agreement:
  - Allows each independent shareholder to nominate one Director per network owned
  - Each independent shareholder has one Director's vote per network owned
  - Each shareholder can nominate fewer Directors than the number of networks owned, on the understanding that these Directors will retain the shareholders full voting power
- Revised proposal is that each independent shareholder can:
  - Nominate one Director per network owned, up to a maximum of two Directors per independent shareholder (e.g. Transco can nominate a maximum of 2 Directors)
  - Voting rights remain unchanged (i.e. one vote per network owned)
- Revised proposal:
  - Reduces total size of the Board
  - Reduces costs associated with Board meetings
  - Stops any one party dominating discussions

# Changes in xoserve ownership with changes in DN ownership

- Shares and right to appoint Directors move with the ownership of the network assets, e.g.:
  - If NGT sells retained DNs these would come with a right to nominate a Director and a shareholding as defined in the shareholders agreement
  - If independent operators sell on their purchased DNs the new owners would assume rights to the relevant shares and the right to appoint Directors
- Special majority voting rules are determined by the total number of independent shareholders in xoserve resulting from changes in ownership:
  - Where there are four or fewer independent shareholders, special majority decisions require the approval of 2 shareholders with 50% of shares
  - Where there are five or more independent shareholders, special majority decisions require the approval of 3 shareholders with 50% of shares