

Paul Darby  
Ofgem  
9 Millbank  
London  
SW1P 3GE

30 June 2011

Dear Paul,

**Proposed Modifications to the “Ring-Fence” Conditions in Network Operator Licences**

Thank you for the opportunity to comment on the proposed modifications. NGN and our shareholders value the expertise and oversight non-executive directors bring which is why they are currently in place throughout NGN's corporate structure.

Consistent with our previous comments NGN has no significant issues with the general suite of changes Ofgem is seeking to make. However, having reviewed the latest drafting we continue to have concerns over detailed requirements surrounding the new licence condition on sufficiently independent directors. These concerns are:

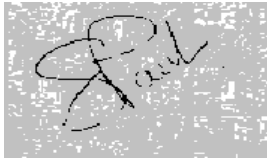
- As presently drafted any independent director of the licensee company excluded from being a non executive director on any affiliate or related undertaking of the licensee company. This prevents such directors from being on the Board of any subsidiary companies of the licensee or immediate holding companies. We feel this is unnecessarily restrictive and could lead to the removal of independent directors from such companies with the consequent loss of the expertise, consistency of approach and oversight. Our suggested approach to resolve this concern is to change the restriction to “executive director or performs executive functions of any affiliate or related undertaking” in paragraph 3.a.ii of the draft condition
- The definition of sufficiently independent as presently drafted in paragraph 3.a.i excludes someone who had previously been a director in the company prior to the company being subject to this condition even if that person would have otherwise met the independence criteria. In practical terms this means existing independent directors who meet the criteria would be prevented from continuing in that role when the condition takes effect. We do not believe this is your intent and the drafting should be revised such that existing independent directors who otherwise meet the criteria can continue in such roles.
- The condition assumes that the licensee appoints directors to the Board of the licensee and is therefore able to control the terms of that appointment. Technically that is not correct as the shareholders appoint directors and agree the terms of their appointment. As currently drafted therefore the licensee is unable to discharge directly the obligations being imposed upon it by paragraphs 5 & 6 of the condition. More generally paragraph 5 which includes the requirement for a statement in the terms of appointment to use best endeavours to remain sufficiently independent we consider is unnecessary given a directors duties in law. Our preferred approach to resolving these concerns would be to remove paragraph 5 and the first sentence of paragraph 6 which relate to the terms of

appointment. In practical terms the provisions that might have to be included within such a form of appointment to ensure the licensee was assured of compliance with the strict requirements might well prove unpalatable to a number of possible candidates in general terms.

Should the licence modifications proceed in the current form then we would need an implementation period of 12 months to make the necessary changes.

Our responses to your specific questions are set out in the appendix to this letter. Please do not hesitate to contact me if you wish to discuss any aspect of our response. Our response can be regarded as non-confidential.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Parker', is shown on a light gray background.

**Stephen Parker**  
**Regulation and Commercial Director**

## **APPENDIX**

### **MODIFICATION OF THE “RING FENCE” CONDITIONS IN NETWORK OPERATOR LICENCES**

#### **CHAPTER: One**

**Question 1: Have we identified the risks and concerns which are important to you if you are a network operator?**

We have no further comments to make.

**Question 2: Do you think that any of our proposals will require a deferred start dates to allow NWOs to make preparations for compliance?**

Yes because the condition on independent directors will require changes to various companies with our organisational structure.

#### **CHAPTER: Three**

**Question 1 Do our proposed changes to the existing ring fence conditions effectively address the risks which we have identified in a proportionate way?**

We have no further comments to make.

**Question 2 Have we satisfactorily addressed the responses to our initial consultation in terms of the impacts and alternatives which were raised?**

Broadly yes the updated requirements on independent directors are welcomed and in principle do not give us any significant concern. However, we do have concerns with the detailed requirements as per our covering response.

**Question 3 Do you think that our proposals will enhance the synergic working of the ring fence and the concept of a defence in breadth and depth against financial or operational distress?**

We think the existing ring fence arrangements are robust and the changes being made will not significantly enhance this.

**Question 4 Do you agree with the exceptions to applicability we have set out for certain types of NWO?**

Yes

**Question 5 Have we drafted conditions which are clear and concise – or are there improvements that we could make?**

Please see our covering response. Notwithstanding the generic power Ofgem has to grant derogations we believe it would be appropriate to include within the independent director condition a specific clause allowing for specific exemptions to be granted following consent by Ofgem on a case by case basis.

#### **CHAPTER: Four**

**Question 1: Do you think our revised proposal to require NWOs to have two sufficiently independent directors (SIDs) is proportionate and addresses the risks we have identified particularly in relation to possible conflicts of interest?**

Yes.

**Question 2: Does our revised proposal alleviate the concerns about legitimate influence and control by NWO owners raised in relation to our initial proposal to require a majority of independent directors?**

Yes.

**Question 3: Do you have any comments on the alternative approaches which are referred to?**

We have no comments on these proposals.

**Question 4: Is our draft condition for sufficiently independent directors clear and concise, or could the drafting be improved?**

Please see our covering response.

**Question 5: If a requirement for SIDs is introduced, how much lead time do you think should be allowed for candidates to be selected and appointed?**

Given the scale of change this will impose we propose 12 months.

**Question 6: Do you agree that the proposed condition for sufficiently independent directors should not apply to independent gas and electricity distribution network operators nor to offshore transmission operators?**

Yes.