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Dear Paul,

Updated Proposals for Changes to Ring Fence Conditions and their Impacts (Ref. 129/2012)

National Grid owns and operates the high voltage electricity transmission system in England and Wales and, as National Electricity Transmission System Operator (NETSO), operates the high voltage transmission system throughout Great Britain and offshore. National Grid also owns and operates the gas transmission system throughout Great Britain (NTS) and, through our gas distribution business, distributes gas to approximately 11 million offices, schools and homes in England.

National Grid would be subject to the proposed modifications to the "ring-fence" conditions in its electricity transmission licence and in its two gas transporter licences in respect of the NTS and gas distribution networks it owns, if these changes are implemented as currently drafted. National Grid therefore welcomes the opportunity to respond to this consultation.

This response is not confidential.

Proposed New Licence Condition – Sufficiently Independent Directors

National Grid continues to believe that the proposed new licence condition concerning board composition has not been shown to be needed or justified, for the reasons that have been set out in our previous consultation responses.

The new consultation accepts some of the points that have been raised in opposition to the new condition, including: that the risks of a network operator being affected by financial distress within a larger group are small; that the primary responsibility for the financial and operational well-being of a network lies with its managers and owners; that there would be some impact on owners rights; that the benefits to network businesses from best practice corporate governance at group level are substantial; and crucially that all company directors have the same legal duties. This only reinforces the need for Ofgem to justify the proposed condition by demonstrating it would bring clear benefit before it is implemented, including and specifically for those licensees where the parent company is listed on the London Stock Exchange and is subject to the UK Corporate Governance Code with all its associated

requirements. However, the benefits as described (and for such companies in particular) remain marginal, are not relevant to the objectives of the ring fence conditions, or depend on mere assertions.

As such, and as explained further in our most recent response dated 31 August 2012, we consider that any decision to implement this proposed new condition would be challengeable as “wrong” for the purposes of Section 11E(4) of the Electricity Act 1989¹. We do not repeat the reasons for this view here, and instead refer Ofgem back to our earlier consultation responses on this proposed new licence condition².

Proposed Use of a new term “Associate” in certain licence conditions

Question 1: Do you agree that the present references to “affiliates” and “related undertakings” represent a weakness in provisions of the restriction of indebtedness condition and the proposed condition relating to sufficiently independent directors?

We do not aware of any material weaknesses in the current conditions or in the proposed new licence condition that result from the use of references to “affiliates” and “related undertakings”, at least in so far as these terms are used in the licences of National Grid’s licensees.

Question 2: Do you consider that the proposed replacement of those references with a new defined term of “associate” will address any such weakness?

As expressed above, we are not aware of any material weaknesses in the current conditions or in the proposed new licence condition that result from the use of references to “affiliates” and “related undertakings”.

Question 3: Do you agree that a new definition of “associate” for the purpose of these conditions should refer to: ultimate controllers of the licensee; “participating owners”; and “common control companies”?

We recognise that the proposed change does capture a wider constituency of non-group companies than the present definitions of “affiliate” and “related undertaking”. It may, quite properly, catch companies involved in some of the more innovative ownership structures which may emerge over time. As such, the proposal appears unobjectionable.

Question 4: Do you consider that the introduction of a new term of “associate” for the purpose of these conditions would be consistent with the objectives we have set out for our review of the regulatory ring fence?

For some licensees the use of the new term of “associate” in the Availability of Resources condition (in relation to the Intervention Plan), Restriction of Indebtedness condition, and Sufficiently Independent Directors condition (if introduced) may extend the scope of the ring fence conditions although the precise scope of this will depend on the ownership structures in question. Where these changes

¹ The same also applies in relation to the equivalent Section 23D(4) of the Gas Act 1986.

² See our letters dated 23 April 2010, 10 November 2010, 30 June 2011, and 31 August 2012 in response to previous consultations on this proposal.

affect existing arrangements, it would clearly be appropriate to allow these arrangements to continue, or at least to provide sufficient time for existing arrangements to be amended without undue cost.

From Paragraph 4.4 of the consultation, it appears that the intention is to extend the restrictions that already apply to Affiliates, Holding Companies, Subsidiaries and Related Undertakings to other less closely related undertakings. It is not, though, explained why such additional other undertakings need to be covered by the relevant provisions of the licence conditions, or why it would be a concern if the new term was not introduced. Alternatively, to the extent that the existing licence wording, covering “Affiliates and related undertakings of the licensee”, already covers the same undertakings as the new term Associate, the changes to the use of the new term have not been justified. It is, therefore, difficult to see whether or how the introduction of the new term is consistent with the objectives of the ring fence, and the use of the new term has not been shown to be “*requisite or expedient having regard to the duties*” of the Authority as required under the Gas and Electricity Acts.

Question 5: What additional impact do you think the introduction of the term “associate” in these conditions could have on your business or other stakeholders?

We do not consider that the introduction of this new term “associate” will have any material impact on National Grid’s businesses.

Comments on certain other changes to the proposals following consultation

With regard to the “Availability of Resources” condition, we support the clarification (at paragraph 2.7 of the consultation) that the first set of new availability of resources certificates will not be due until 31 July 2014 and the removal of the words “*at all times*” in relation to the maintenance of an intervention plan.

In relation to the “Form of ultimate controller undertakings”, we agree that the draft direction should be changed to make clear that the new forms will only need to be used when a new requirement to obtain an undertaking arises.

Finally, with regard to the “Restriction of Indebtedness” condition, we continue to consider that the phrase “*formal covenant pertaining to its financial affairs*” should be made a defined term in the condition, with the meaning “*formal covenant contained in any loan agreement, commercial paper, bond issue or committed facility*”.

Yours sincerely

[By e-mail]

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