Appendix 3: Proposed Regulatory Corporate Governance Statement Principles

Introduction

These principles expand on the principles of corporate governance set out in the UK Corporate Governance Code (UK Code) to help boards of directors and users of accounts interpret the UK Code's application to licensed operators of energy networks subject to price control under RIIO. ~~They may also be relevant to the governance of groups that contain licensee companies.~~

This should be deleted as the regulator cannot purport to give guidance to entities it does not regulate.

If it is Ofgem's intention that the RCGS Principles will apply in addition to the UK Code, it will impose an additional resource and cost burden on the NWOs and will have the inevitable consequence of making the RCGS lengthier and, in all probability of less interest to stakeholders. If it is Ofgem's intention that only the RCGS principles apply, that requirement should be made clear in the proposed licence condition.

These principles are not a rigid set of rules and an alternative to following them may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for ~~it~~doing so should be explained clearly and carefully to shareholders in the company's annual RIIO Accounts.

This is not consistent with the UK Code, which is based on the premise of "comply or explain" and includes provisions in support of the main principles. Companies with a premium listing are expected to adhere to the main principles and one of the ways in which companies with a premium listing can meet that requirement is by the application of the supporting provisions. It is possible and permitted to achieve the intention of the main principles by other means. However, if this is done, companies must explain why they have chosen not to apply the provisions. If the "principles" laid out here are to be on the "comply or explain" basis, they should be called "provisions" and be in support of an overriding principle, consistent with the approach adopted in the UK Code.

The main focus of these principles remains the relationship between the company and its shareholders. In light of their regulated status, companies are encouraged to recognise the role of other stakeholders and to confirm the board's interest in listening to their views and understanding their interests insofar as these are relevant to the licensee company's overall approach to governance.

While governance of a company is the responsibility of that company's board, these principles recognise that some aspects of the governance of a company subject to licence obligations may be shared with companies within a group. It would be for the company's board of directors to be satisfied that the company's governance, taking all aspects together, operates in the company's interest and meets appropriate standards.

Leadership

RA1 - When setting the company's values and standards and ensuring that its obligations to its shareholders and others are understood and met, the board is encouraged to recognise the obligations the company has under its licence. The board is also encouraged to recognise that the longer-term success of the company's licensed business~~es~~ is supported by ~~depends on~~ effective engagement with, and maintaining the shared interest of, a wide range of other stakeholders - including consumers and the Ofgem~~regulator~~.

The statement should include an explanation of this coding.

Effectiveness

RB1 - When identifying in the annual ~~report~~ RIIO Accounts each non-executive director it considers to be independent, if relevant, the board should refer to the company's licence requirement to have two Sufficiently Independent Directors~~,~~ and explain the roles played by those directors~~,~~. ~~and~~The board should also explain the governance relationships between any wider group and the company.

Accountability

RC1 - These principles are relevant to the annual RIIO Accounts of a company that is required to prepare them and should be considered by the board in presenting its statement of regulatory corporate governance.

This paragraph should be moved to the introduction as it appears to apply across the principles.

RC2 - In exercising its responsibility to present a fair, balanced and understandable assessment of the company's position and prospects, the board should take account of ~~the company's regulated business model and~~ the wider range of stakeholders who have an interest in and an ability to influence its future.

Business model is not relevant here and see comment in RC3.

RC3 - The directors' explanation of the basis on which the company meets its objectives ~~generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company~~ should refer to the benefit sharing nature of the regulatory incentive regime the company operates under~~, and~~ in respect of the ~~shared~~ interests of consumers and investors ~~in the company's success~~.

The interests of consumers and investors are not necessarily always aligned, as this principle appears to suggest. Ofgem should not be determining the business model.

RC4 - Reflecting the benefit-sharing nature of the regulatory regime the company's licensed businesses operate under, ~~and that demonstrating benefits for consumers helps maintain the perceived legitimacy of the regime~~, the directors should explain how consumers have benefited from performance alongside the benefits for shareholders. The directors should also explain how they satisfy themselves that the company's interactions with their pension schemes ~~and industry code governance arrangements~~ promote the interests of consumers as well as of shareholders whilst having regard to all relevant regulatory (industry and pension) and legal requirements.

We do not consider demonstrating the legitimacy of the regime to be an appropriate aspect of the statement and it is difficult to see how the consumer interest in usually complex industry code arrangements can actually be evidenced.

RC5 - In explaining the basis on which the company preserves value over the longer term ~~(the business model)~~, the directors should describe how the ring fence conditions and price control arrangements in the company's licence~~s~~ help ensure the company's longer term financial viability.

RC6 - In confirming their robust assessment of the principal risks facing the company, the directors should describe how the principal risks affecting consumers, both in terms of tariff and service levels and in the shorter and longer term, are being managed or mitigated.

RC7 - The board's report on its review of the company's risk management and internal control systems should cover its controls over compliance with its licence obligations.

~~RC8 - The board should satisfy itself that the terms of reference for the main role and responsibilities of the audit committee that the board relies on for oversight of the company's risk management and~~

~~internal control systems, which may be a committee of the holding company's board, covers the company's controls over compliance with its licence obligations.~~

This effectively duplicates RC7 because the operation of an audit committee is part of a company's risk management and internal control systems.