

APPENDIX B – INVESTOR/ANALYST FOCUS GROUP FEEDBACK

(Some Qualitative Responses on Key Issues)

A. Is there an appetite in the market to invest in TSO assets?

“Investors have said there is real shareholder value in [network] assets and if you talk to many of them, they are saying, there is a price.”

“I think that there are quite a lot of people who, for reasons totally divorced from what we are talking about here (unbundling, TSO), have money that they have to invest in this sector.”

“That is one of the benefits of the Third Package because if people see it as moving down a path, a lot of companies will try and be ahead of it. In the UK, people tried to sell their distribution businesses and worked out different ways of getting ahead of the game.”

“You do not have to be very big to invest in networks or generation. There are lots of conditions you have to meet, but being big is not one of them.”

“Once you have a framework that lets people value them, I think companies will be incentivised to spend more.”

“I think that whatever happens on carbon will impact on the mix of generation's assets and [so] will have a quite important bearing on the amount of investment that is required in things like grid and transmission going forward”

“Developments in the equity and debt markets have meant that certainly recently, those remaining utilities which have power transmission would be well-served by full ownership unbundling transmission and many of them wish to do that”

“When newer types of investors look at owning a large utility which has 20% of its value in a heavy capital employed, low growth business, they say, “Could you not improve return on capital employed?”

“[Another] element which controls [investment] decisions is the extent to which they need the money and they have got somewhere else to spend it”

“I get a sense that because of the push from equity and debt markets, some of the more publicly intransigent companies are, in private, more willing to sell than people think, but they are not wanting to undercut their politicians and are therefore being more restrictive”

“Certainly in the UK, it is clear, that there is a large appetite to buy infrastructure including some of our utilities and distribution businesses.”

“For the equity markets, it is much better to finance these companies directly unbundled as it is cheaper than doing it through the parent”

"I think the appetite is there. We have encountered plenty of people who are desperate to buy European infrastructure."

B. What would persuade the market to invest in TSO networks?

"Regulatory uncertainty needs to be improved, it requires a process whereby if you package this up and sell it, this is the regulatory environment it will be sold under."

"The biggest blockage is that the regulatory regimes in many of the European countries are embryonic."

"There is not any quick way to solve [regulator uncertainty,] the regulators can make all the pronouncements they like, but what investors tend to like is a few years of track record."

"Investors want to know when they put money into a company that there is a reasonable prospect of attaining a reasonable return"

"In Europe [there is no legal principle which gives some security] all you have got is the reputation of the individual regulators and a range of possible methods as a way of getting security. That is a real problem."

"Some regulators are legally unable to give long-term commitments on security of an investment"

"You would expect investors to have confidence to the extent to which the local regulators have taken that on board [European wide legislation] and have started to apply these processes."

"I do not think you have to do very much to begin to bring in the investments."

"You want something in the Directive that investors will consider bankable."

"How much risk do you want to place back onto the network operator? Do you want to reward them or punish them for taking on and managing that risk?"

"Certainly some kind of financial inducement might be a good idea."

"If a TSO ownership unbundles then a regulator could give this TSO a five or ten-year tariff methodology"

"You can think about regulatory discounts for reduced costs."

"Good regulation needs to be put in place so that these companies can be valued and understood"

C. What would persuade incumbents to sell their TSO networks?

“On the basis of gas transmission networks costs, and these values vary considerably. This is a good time to sell if you think your [knowledge is comparatively more accurate than that of your competitors regarding what] the outcome is going to be”

“If you do not like the risk and if you think that someone else will pay you a premium because their perception is that they are more likely to go with it”

“It is a good time to sell if you are selling to a very informed buyer”

“Regulatory risk is more a question about what new investment is going to be required by the regulators.”

“When that push from shareholders becomes greater, you will find management being very willing, I think, to sell.

“It depends what they did with the money. If they took the money out of a safe regulated business and burnt it in the car park then, no, probably not.”

“Their real concern about unbundling is somehow what they consider to be expropriation because incumbents say, “We made investments under a different set of arrangements.”

“I have come across no utility which is totally adverse to selling its transmission network”

D. Is the EU Commission’s “deep” ISO option workable?

“You have got the deep ISO model which, in my view, is pretty flawed”

“I think that ownership of the transmission assets still give[s] access to valuable information and valuable insights”

“The regulators have to commit to deep and ongoing pain to regulate the boundaries between the deep ISO and the market”

“When you divorce someone who is the operator of the ISO, the system operator, from who legally owns the assets, then the problem is precisely how you get people to invest.”

“The ISO has no assets, it is not creditworthy and no one will lend them the money to make the investment.”

“Does the ISO system, has any interest in doing anything efficiency in terms of capital investment?”

“The ISO idea works if all you are concerned about is open access and common rules and third party access, Once you worry about efficient investment then the idea just crumbles in front of you.”

“The ISO was seen by the commission as something to push people into ownership unbundling.”

“If we go down the ISO route, we end up with a muddle, which is going to be very complex and difficult to run and it is not clear what that is going to lead to.”

“There needs to be a clear path from an ISO to an option of having full ownership unbundling”

“Depending on the ISO it is possible to do creative things. Governments could sell a proportion and the ISO will control the rest and so effectively creating a position whereby they are testing the market.”

“It is clear at the moment – and probably a reflection on whether you can make the ISO model work -- that ownership of those transmission wires still confer significant strategic advantages on generation supply businesses.”

“My worry about the ISO is not only is it expensive to run, but it is all about interfaces. It is expensive to manage and do you ultimately get the transparency that you are really looking for?”

"Actually, there are these big investments. There is no need to fund network investment on a monopoly basis." We can say to the grid company, "By all means bid for it, but we are going to invite others to do it." That is why I am a bit nervous about completely killing off the ISO as a model"

“The rapidity with which an alternative to full unbundling was being talked about by the Commission was extremely negative, I think.”

E. What could be the “third option” on effective TSO unbundling?

“There is a discussion of a Third Way, the only Third Way that I can envisage is a “shallow” ISO”

“I have some sympathy with diluting the proposals for the ISO to make it attractive enough for incumbents to adopt -- instead of just putting pressure on the governments to kill the whole legislation”

“Part of the problem with the Third Way is that there might be more than one Third Way”

“Potentially, it is State-ownership with the TSO part reporting to a different part of the government than the production and supply bit”

“Like the deep ISO model, I would say it is likely to need a very strong amount of regulation to make it work”

“Incumbents will all find 101 ways in which the ISO model can be made ever shallower.”

"I worry that if you go for a compromise, it might become even harder to go for full unbundling later down the line, which ultimately is the effective outcome"

"One argument why you might want a Third Way is not because of what it is itself, but it kind of gives you a guarantee that for example in Germany all four will do the same thing, whatever that thing is"

"We want there to be a framework to allow companies to fully unbundle but, at the same time, if there is no full unbundling, we need the following criteria to make thing work."

"The transmission management and the board will be very, very independent from the production company and from the common owner. It is not so extreme like the ISO where the owner has only the right to invest"

"They will have access to the capital of the parent company, of the owning company, and there will be finance available from the capital market itself"

"On the network ownership, if you have government owned networks in Europe, you want to be political boundaries. Do you want the French government owning the Belgian network? Do you want the French government owning the German network? You start running into the same problems. That is where the political solution starts to fall apart."

F. What is the likely outcome on TSO unbundling in France and Germany?

"French and the Germans are working on a Third Way"

"Imperfect ISO models can be made to suit national objectives"

"If I was French, what you would want is to make sure that these companies are not acting in a rapacious manner, regarding their shareholders' interests at the expense of their competitors but, "Do not worry, we will regulate them by owning them."

"You know that the German regulator, for independent reasons, is against TSO unbundling, but there are a lot of [investment] opportunities in Germany, especially in the municipal sector."

"You have introduced a good system. So long as that system stays in place and so long as you set a sufficiently high rate of return, you will find the capital."

"France is not that unlikely to agree to some compromise on the electricity side because, at the end of the day, as it is structured now, shifting RTE to some other State-owned entity, it is not a big thing"

"France is interested to get rid of the grid, but at a price which is decided politically, which is not the result of due diligence and market consideration. It will be a political deal. The grid will be bought by the State-owned bank which is holding EDS shares and other industrial shares"

“If the Commission allows them to keep the merger between SUEZ and Gaz de France intact and accepts a murky ISO structure, which is just saving face, it might happen”

“One route would be to create a German state owned national grid - It could be possible, it would not be an issue because several countries in Europe are living very well with national grids. Part of the nationalized company could then be sold off to private investors.”

MOFFATT ASSOCIATES

January 2008