

Elxon: Subsidiary Formation Note: 11 March 2013

1 Introduction

1.1 This summary note is addressed to Elxon Limited (“Elxon”) alone.

2 Subsidiary Formation

2.1 We understand Elxon proposes to form a wholly-owned subsidiary (to be named “EMR Settlement Limited”) (“EMRCo”) to act as the settlement agent carrying out EMR related services for and on behalf of the CfD counterparty and the capacity market settlement body.

2.2 When companies resolve to undertake wholly new activities, they are faced with a decision of whether to operate those activities through a new business unit or to form a new subsidiary.

2.3 Each set of circumstances has individual features, but forming a new subsidiary is a popular way to proceed. This is for various reasons which typically include tax and financing factors, but also as an effective way of an organisation managing risk as:

- (a) the subsidiary activities have a natural, legal ring-fence which is clear and defined to third parties;
- (b) the rights and obligations of the subsidiary are, as a general principle, the responsibility of the subsidiary alone;
- (c) in the absence of the parent providing any guarantees / assurances on behalf of the subsidiary (which we are informed by Elxon is not the case here), liabilities arising in the subsidiary stay within the subsidiary and the parent is protected. A typical example would be where a claim is made by a third party which would be against the subsidiary, not against the parent¹.
- (d) Whilst there are cases where the courts will look beyond the contractual position (known as piercing the corporate veil), this is typically limited to exceptional circumstances² and claims ought to be brought against the subsidiary alone. Notwithstanding these exceptions, it is still typically considered to be more prudent to form a subsidiary than to operate the activities within the parent; and
- (e) in a worst case scenario of subsidiary failure, the parent’s liability will be limited to the share capital it has invested in the subsidiary and also any unsecured loan funding which has been made available (the subsidiary not being able to repay if it is insolvent). We understand that the share capital of EMRCo will be £2, comprised of 2 ordinary shares of £1 each held by Elxon and lending by Elxon to EMRCo is restricted by the BSC.

¹ Whilst it may be possible to limit or even avoid liability where there is a contract with the third party, liability can also arise even though there is no contractual relationship, if there is found to be a duty of care owed to that third party (known as a claim in tort). Therefore limiting liability in a contract is not necessarily the whole solution as it is difficult to obtain and does not cover all routes of claim. It is therefore better to keep the activities in, and hence any claims restricted to, a subsidiary.

² In cases where the courts have proceeded to look through the corporate structure, the subsidiary has been used by its parent/controller for a wrongdoing which existed entirely because of the parent/controller.