

Arrangements for responding in the event that an energy network company experiences deteriorating financial health

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Target audience: All network licensees. Network company investors, debt holders and equity analysts. Consumer groups, suppliers, generators and gas shippers. All other interested parties.

Overview:

This document sets out our response plan to the case where an energy network company faces deteriorating financial health. A number of aspects of the document relate only to a protected energy company (PEC). The document provides guidance on the procedures Ofgem may use, including in the event that a PEC is placed into energy administration. We have tested these procedures by a simulation exercise.

The document has not been prompted by concerns about any particular network company. We have had in place robust arrangements for dealing with the financial distress of a network company for a number of years. The network companies understand these arrangements. Given current conditions in the capital markets and in light of our better regulation duties, we think it is important to set out these arrangements in a single document. We will review this document periodically to keep it up to date and make sure it continues to set out an efficient basis for responding to a case of financial distress.

Contact name and details:

Hannah Nixon - Partner, Regulatory Review
Grant McEachran - Senior Manager, Transmission Policy

Tel: 0207 901 7165 / 0141 331 6008

Email: hannah.nixon@ofgem.gov.uk / grant.mceachran@ofgem.gov.uk

Local Grids & RPI-X@20

Associated Documents

- Arrangements for responding in the event that an energy network company experiences deteriorating financial health – Consultation Document – Ofgem, May 2009 #49/09
<http://www.ofgem.gov.uk/Networks/Policy/Pages/Policy.aspx>
- Arrangements for responding in the event that a network company experiences deteriorating financial health: Position Paper - Ofgem, December 2008 #158/08
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=245&refer=Networks/Policy>
- Supplier of last resort: revised guidance – Ofgem, December 2008
http://www.ofgem.gov.uk/Licensing/Work/Revoc/Documents1/SoLR_revised_guidance_-_December_2008.pdf

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Summary

Ofgem's principal duty is to protect the interests of present and future consumers. In the absence of mitigating measures, the implications of a network company experiencing financial distress and struggling to maintain and develop its network may be to impact consumers through a reduction in service and/or reduced security or quality of supply.

Ofgem has arrangements in place to monitor the financial health of network companies and to respond in the event that one or more of those companies faces deteriorating financial health. This document sets out at a high level the processes that may be applied in the case of a network company experiencing financial distress.

For the most part this document sets out the arrangements which apply to all network operators licensed under the Electricity and Gas Acts. However, a number of aspects of the document relate only to a protected energy company (PEC). The Energy Act 2004¹ defines a 'protected energy company' as the holder of a licence granted under:

- a) section 6(1)(b) or (c) of the 1989 Act (transmission and distribution licences for electricity); or
- b) section 7 of the Gas Act 1986 (licensing of gas transporters).

Arrangements for responding to deteriorating financial health

There are a range of arrangements in place that manage effectively the risks to and impact of deteriorating financial health of a PEC on consumers. These arrangements are well understood by those companies and include:

- requirements on PECs to provide to Ofgem on an ongoing basis a series of statements providing details of their financial health – these include an annual 'Certificate of Availability of Resources' which requires each company to provide a certificate, signed by a company director, setting out that the directors of the licensee have a reasonable expectation that the licensee will have sufficient financial resources and financial facilities to enable it to carry out its activities for a period of 12 months;
- procedures for collecting and monitoring additional network company financial and operating data;
- financial ring fencing conditions which place constraints on the operation of network companies including provisions for cash-lock up;
- provisions for reopening/disapplying price controls; and
- the ability, with the consent of the Secretary of State, to apply to the Court to place a PEC into special administration.

The primary responsibility for the financial integrity of a network company lies with that company's management and shareholders. The regulatory framework provides strong financial incentives on network companies to strive for greater efficiency whilst still meeting the terms of their regulatory settlements and their legal duties and obligations relating to providing reliable, secure and safe networks.

We expect companies to act responsibly and to inform Ofgem at the earliest stage possible of any potential or actual financial distress. The earlier that a case of financial distress can be identified, the more response options we have available that may help to mitigate and/or contain the situation.

¹ Sections 154-156: http://www.opsi.gov.uk/acts/acts2004/ukpga_20040020_en_1

Structure of the document

The document is split into three parts.

- Part 1 sets out the purpose of this document and the background to the topic of financial distress.
- Part 2 is the main body of the document and sets out the indicative procedures Ofgem may follow both pre-administration and in the event of energy administration.
- Part 3 sets out a series of appendices which set out more detail on specific aspects of Ofgem's arrangements.

We have tested the robustness of our procedures in a simulation exercise.

This is the first version of the document. We will periodically update it to ensure it continues to reflect the legal framework, regulatory arrangements and best regulatory practice.

Disclaimer

This document is intended to provide guidance about Ofgem's indicative approach in the event that a network company experiences financial distress. Any such case of financial distress or failure that occurs will turn on its own particular facts. As such, the indicative approach set out in this document is not intended to restrict the scope of the Authority's² powers or the exercise of its discretion whether under licence, statute or otherwise. Neither is it intended that this document creates any legitimate expectation that specific cases will be dealt with in a particular manner. References to primary and secondary legislation, licence conditions and other documents that are publicly available are high level references only and are not a substitute for the primary text.

² The Gas and Electricity Markets Authority (GEMA, or the Authority) is the body established by Section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain. It is supported by the Office of Gas and Electricity Markets (Ofgem). References to GEMA, the Authority and Ofgem are used interchangeably in this document.

Part 1: Process overview

This section introduces at a high level the purpose of this document as well as its limitations, and sets out where responsibility lies for the maintenance of the document. It also discusses the core concepts relevant to energy administration and sets out the background to the existing energy administration regime.

1. Purpose

This chapter sets out the purpose of this document. It sets out at a high level what the document proposes to do as well as its limitations. It also sets out where responsibility lies for the maintenance of the document.

1.1 Purpose of the document

Ofgem has a central role in the process where a network company experiences financial distress.

The purpose of this document is to set out, by way of guidance, a response plan to cases of financial distress. This includes pre-administration procedures, the appointment of energy administrators and the interaction with external parties such as the Department of Energy and Climate Change (DECC) and consultants that are likely to be involved in the process of energy administration.

1.2 Limitations of the document

This document is intended to guide Ofgem's approach to cases of financial distress. This does not mean that it will address all aspects of Ofgem's response to cases of declining financial health. We appreciate that any case of financial distress that arises will turn on its own facts. As such, the indicative arrangements covered by the document are not intended to provide any expectation that individual cases will be dealt with in a particular way. Any case that arises will be considered on its merits and individual facts. There are limitations to the coverage and application of this document.

1.2.1 Areas applying only to PECs

For the most part this document sets out the arrangements which apply to all network operators licensed under the Electricity and Gas Acts. However, a key number of areas only apply to PECs namely the energy administration arrangements, financial ring fencing provisions and price control provisions and thus reopeners/disapplication provisions.

1.2.2 Supply businesses

This document is intended to address Ofgem's approach to cases of energy administration. It therefore only relates to PECs. Competitive energy businesses can also fail. Ofgem has in place separate arrangements for responding in the event that a supply business faces financial difficulties.

1.2.3 Monitoring arrangements

This document is concerned solely with the procedures that Ofgem will consider applying in responding to circumstances where a PEC faces financial distress. The monitoring arrangements are not considered in detail in this document.

1.3 Ownership of the document

Ownership of the document, including responsibility for keeping it up to date, will rest within the Networks division, and specifically with the regulatory finance team. However, in the event of a PEC facing financial distress, there will be roles for a number of teams in Ofgem.

As the party responsible for managing network incidents, there will be a significant role for DECC in the event of a PEC experiencing financial distress. We will continue to seek ongoing input from DECC and update this document as appropriate.

2. Background to the energy administration regime

This chapter discusses the core concepts relevant to energy administration and sets out the background to the existing energy administration regime.

2.1 Financial distress

2.1.1 Definition of financial distress

Financial distress describes a situation where an affected party cannot access the financial resources required to discharge its obligations. In the case of a PEC, this means that it may struggle to finance its licensed activities.

There are a number of potential causes of financial distress. In some cases they directly reflect the actions or strategies of the affected business such as the failure of management to control expenditure or excessive gearing where a business relies heavily on debt to finance its activities. They can also result from the actions of another party such as the default or insolvency of a major trading partner. Finally, financial distress can also result from the impact of regulatory or Government action that may impose additional costs on a business or make it less attractive to investment. It is possible that financial distress may result from a combination of factors.

Where a PEC experiences financial distress it may seek to reduce its expenditure and dispose of surplus assets. It may also seek to renegotiate existing obligations; one obvious example would be to seek to reopen its price control to secure more favourable terms. If these measures fail to improve the financial position of the PEC it may become insolvent. Insolvency is a position where a company's liabilities exceed the value of its assets and/or is unable to pay its debts as they fall due.

2.1.2 Indicators of financial distress

While a company's financial position can deteriorate quickly, financial distress generally results from a combination of effects over time. Consequently, there are a range of potential indicators or "warning signs" of financial distress. These include commercial intelligence, the default or insolvency of a major trading partner and adverse outcomes of major litigation.

Each of these areas can provide a signal of the financial health of a business. However, individually a number of the areas may not necessarily result in a PEC facing financial distress. Moreover, by the time there are clear signals of financial distress, there may be little time for Ofgem to take action. We therefore have in place monitoring arrangements that are designed to identify signs of deterioration in the financial health of a PEC. However, such monitoring arrangements do not, and cannot, guarantee that a case of financial distress will always be identified in advance.

We expect PECs to act responsibly and to inform Ofgem at the earliest stage possible of any potential or actual financial distress. The earlier that a case of financial distress can be identified, the more response options we have available that may help to mitigate and/or contain the situation.

2.1.3 Scope for financial distress

Historically, the possibility of a network licensee, or following the Energy Act 2004 a PEC, becoming insolvent has been regarded as unlikely. They can be considered to operate in low risk market segments. Since privatisation no PEC in the gas or electricity sectors has gone into energy administration. However, the growing trends of combining network businesses with other, more risky, activities in the same corporate group, and of highly-leveraged financing structures, increase the risk of financial failure. Further, the prevailing economic conditions – particularly tight credit market conditions – increase the likelihood of financial distress for all companies.

2.2 Process of administration

Administration is a mechanism for dealing with an insolvent company. It is unlawful for a company to trade while insolvent. Under administration, an administrator is charged with attempting to restructure the company to which it is appointed so that it may resume normal trading. Alternatively, if this is impracticable within a reasonable timeframe, or a better outcome for creditors can be secured, then the administrator will sell the company or its assets and undertakings.

In the UK the administration regime is governed by the Insolvency Act 1986³, as amended by the Enterprise Act 2002⁴.

2.3 Energy administration regime

An energy administration regime was established through primary legislation in the Energy Act 2004. As stated in the summary to this document this legislation provides the definition of a 'PEC'.

The principal role of the administrator under insolvency arrangements is to obtain the best possible outcome for the owners and creditors of a company. Reflecting the importance of energy networks to consumers, the aim of the energy administration scheme is to ensure that essential services to consumers remain secure and uninterrupted in the event of a PEC becoming insolvent. This includes ensuring that the relevant PEC's system is, and continues to be, maintained and developed as a safe, efficient and economical system. The PEC's system is defined as the system of electricity distribution or electricity transmission, or the pipe-line system for the conveyance of gas. Similar special administration regimes are in place for the water and rail industries.

2.4 Legal framework

Ofgem's principal duty is to protect the interests of current and future consumers. The implications of a PEC experiencing financial distress may directly impact consumers. In addition, Ofgem has a duty to secure that PECs are able to finance the activities that are the subject of obligations under the Gas Act 1986 (the Gas Act) and Electricity Act 1989 (the Electricity Act) and other relevant legislation notably the Utilities Act 2000 and the Energy Act 2004.

³ The Insolvency Act 1986, <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/uk/insolvencyact.pdf>

⁴ The Enterprise Act 2002, http://www.opsi.gov.uk/Acts/acts2002/ukpga_20020040_en_1

This does not mean that Ofgem would provide regulatory relief to alleviate financial distress in all circumstances. We would consider why a PEC faced financial distress and to what extent it had financed and operated the relevant network efficiently. PECs have an obligation to develop and maintain efficient and co-ordinated systems. Where financial distress arises despite the PEC operating in an economic and efficient manner, Ofgem would consider, at its discretion, what tools, if any, are appropriate to respond to that distress.

Appendix 1 sets out an overview of the relevant legal framework.

2.5 Application of the document

This document applies to protected energy companies (PECs). As stated earlier in this document, PECs comprise entities that hold network licences granted under section 6(1)(b) and (c) of the Electricity Act or section 7 of the Gas Act. The PECs are:

- the three electricity transmission businesses – National Grid Electricity Transmission (NGET), SP Transmission Limited (SPTL), Scottish Hydro-Electric Transmission Limited (SHETL);
- National Grid Gas National Transmission System (NGG NTS);
- the fourteen electricity Distribution Network Operators (DNOs);
- the Gas Distribution Networks (GDNs);
- the Independent Gas Transporters (IGTs); and
- the Independent Distribution Network Operators (IDNOs).

The PECs are often not independent entities in their own right but rather are owned by other companies, including financial institutions, or are part of a wider Group structure. Therefore, it is not only the specific circumstances of a PEC that reflect its financial position. Pressures from elsewhere in a Group could impact on the financial position of a PEC.

A full list of the current network licensees (including the PECs) and the parent companies of those network licensees is set out in Appendix 3. The lists of network licensees and group owners will change from time to time. One obvious example will be the inclusion of the offshore transmission owners from 1 July 2010. However, the changes will not only include the number and type of network licensees but also their ownership structures. In order to ensure that this document remains a useful tool for addressing cases of financial distress, it will be necessary to keep the information on network licensees up to date.

2.5.1 Interconnector companies

An additional category of network licensee is interconnector companies. There are currently operating, or in development, six electricity interconnectors and four gas interconnectors to Great Britain. The arrangements for interconnector companies differ from those for the PECs. In particular, in the case of interconnectors there are:

- less detailed compliance requirements under their licences;
- no financial ring fencing provisions; and
- no energy administration provisions.

One reason for the more light touch nature of these arrangements is that, in many cases, the key regulatory responsibility for regulating these businesses lies with overseas regulatory authorities. On this basis, most aspects of the arrangements set out in this document will not apply to interconnector licensees. However, Ofgem will continue to monitor the financial health of interconnector companies and will take action, where necessary in cooperation with overseas regulatory authorities, to ensure the interests of consumers are protected in event of the deteriorating financial health of one of these companies. The table of network companies set out in Appendix 3 of this document includes the interconnector businesses.

2.5.2 Offshore transmission networks

In future network licensees will also include a number of offshore transmission owners (OFTOs). Offshore transmission is defined as being any offshore transmission network that operates at 132kV or above. Offshore transmission will be a licensed activity, regulated by Ofgem.

The arrangements for responding to the financial distress of an OFTO would largely reflect those for onshore parties. However, in the case of OFTOs additional provision has been made for an 'OFTO of last resort' mechanism. The mechanism is given effect by a licence obligation on all transmission owners to act as OFTO of last resort when directed to do so by the Authority. Standard Licence Conditions B18 and E21 outline the relevant obligations.

Part 2: Indicative procedures (pre-administration and in the event of energy administration)

Part 2 is the main body of the document and sets out the indicative procedures Ofgem may follow both pre-administration and in the event of energy administration.

3. Pre-administration arrangements

This chapter sets out an overview of the likely stages that may be followed pre-administration in response to a case of a PEC experiencing financial distress. It also sets out an overview of two of the key elements of Ofgem's pre-administration arrangements. These are:

- monitoring arrangements; and
- financial ring fencing provisions.

Further details on each of these areas are set out in appendices to this document and are referenced below. We still expect PECs, who will be or ought to be aware of their financial position, to act responsibly and to inform Ofgem at the earliest stage possible of any actual or projected financial distress so that the Authority may consider in light of any representations made what, if any, action to take, at its discretion, to prevent further financial distress or financial failure.

3.1 Key stages of the pre-administration process

There are a number of steps and measures that could be taken before a PEC would be placed in energy administration. These are likely to include the following, the first two of which are always in place.

Stage 1 – Monitoring financial health

The impacts of a case(s) of financial distress are more likely to be mitigated if action is taken at an early stage. In an attempt to identify potential cases of financial distress at an early stage and to be in a position to take measures promptly should financial distress arise, Ofgem monitors the financial health of PECs. Ofgem collects information about PECs from a number of different sources, and uses that information to monitor the performance of those companies against their price controls and wider performance indicators. In particular, Ofgem considers:

- required licence "compliance" reports, including cost, revenue and quality of service reporting; and
- market indicators, including share price movements, credit ratings and market implied ratings.

The monitoring process provides us with a wide range of information on the financial health of PECs. The PECs are assessed against this information on an ongoing basis and their compliance with regulatory parameters, including those set by price controls, is monitored.

Further information relating to these areas is set out in Appendix 4.

Stage 2 – Financial ring fence

The licence conditions of PECs contain a suite of conditions known collectively as the 'financial ring fence', which places constraints on the operation of PECs. This includes a requirement on PECs to maintain an investment grade credit rating and the provision for a cash lock-up in certain circumstances between the PEC and its affiliates.

The purpose of the financial ring fence is two-fold. Its primary purpose is to ensure that the assets, cash-flows and other financial resources of PECs are applied to meet the needs of the regulated business. It ensures that resources sufficient to meet the needs of the regulated business are not diverted to any other purposes nor exposed to any unrelated risks. The second purpose is to ensure that Ofgem has access to information to monitor the financial position of PECs, has early warning of severe deterioration and is able to consider what action to take in the event of a breach. As such, they also provide the basis for enforcement action by Ofgem.

We recognise that not all of the ring fence conditions may prevent, or indeed provide a signal for, deteriorating financial health among all network PECs. For example, a number of smaller PECs such as IGTs and IDNOs are ineligible for credit ratings regardless of their financial health. However, in such circumstances there is scope for, and indeed Ofgem has approved, alternative arrangements involving the parent company of a PEC entering into a 'keep well' agreement which sets out a series of undertakings in favour of the PEC.

Further information on the specific details of the financial ring fence is set out in Appendix 5.

Stage 3 – Price control reopener

The PECs are either subject to full price controls or, in the case of IDNOs and IGTs, relative price controls. One option that may alleviate financial distress could be to reopen or disapply an existing price control. Reopening a price control would not be an option in all circumstances and we think there would need to be strong and compelling reasons to reopen a price control settlement.

Further details on price control reopeners are set out in Chapter 4.

Stage 4 – Trade sale

Another option that may prevent the requirement for a PEC to enter energy administration would be a trade sale, whereby another company purchases the assets of the PEC in financial distress. A trade sale is more likely to be practicable with a smaller PEC.

Ofgem considers that trade sales are generally more desirable than regulatory intervention. However, Ofgem would need to consider the impact of a sale including the likelihood of the new PEC experiencing financial distress in the future.

The sale of a PEC may also occur during an energy administration process. The issues associated with the sale of a PEC are considered in more detail in Chapter 8.

Stage 5 – Energy administration

In the event that none of the above measures addresses the financial distress of a PEC then DECC (or GEMA with the consent of DECC) may file an application with the Court to place the PEC into energy administration. The energy administration process is set out in Chapter 5 and discussed in more detail in Chapters 6 to 9 of this document.

4. Reopening a price control

This chapter considers the issues associated with re-opening a price control as a means of addressing a case of financial distress.

4.1 Background

A price control sets the financial parameters within which certain network licensees must operate over a number of years. Not all network licensees are subject to price controls, but every licensee that has a price control is a PEC. All transmission operators and distribution network operators have price controls. A number of the independents have relative price controls and none of the interconnector companies are price controlled. Therefore, re-opening a price control will not be an option for all network licensees.

Ofgem has generally set price controls for a period of 5 years. We consider that this period provides a reasonable balance between the interests of the network licensees and consumers as it provides incentives for the licensee to improve efficiency, while generating a degree of regulatory certainty⁵.

In setting a price control Ofgem seeks to provide a licensee with a revenue stream that is sufficient for it to meet its statutory and regulatory obligations if it is operating in an efficient manner. However, we recognise that circumstances may develop in which the revenue stream set in a price control ceases to provide sufficient funds for a regulated licensee. In such cases one option is to 'reopen' a price control during a regulatory period to re-set revenue allowances or the parameters that give rise to those allowances.

Appendix 6 sets out further information on the current price controls including details of the key price control formulae.

4.2 Scope for reopening a price control

There are two different approaches for reopening price controls: (1) a specific 'reopener' provision; and (2) disapplication provisions.

Ofgem has made provision for price control re-openers in each of its current price controls that relate to specific events. There are no specific reopener provisions relating to cases of deteriorating financial health.

In contrast, a disapplication request enables control parameters to be reset for a broader range of reasons than those determined by specific reopener provisions. All network licences that have a price control have a licence condition making provision for a disapplication of the price control, or general reopener. The conditions are as follows.

- Special Condition D8h (Duration of the Transmission Network Revenue Restriction) of National Grid Electricity Transmission Ltd transmission licence.

⁵ Ofgem is currently undertaking a two-year project to review the workings of the current approach to regulating GB's energy networks and develop future policy recommendations – the RPI-X@20 review. The recommendations of the review are due to be reported to the Authority in 2010. This will consider a range of issues including the length of the regulatory period.

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- Special Condition J9 - (Duration of the charge restriction provisions) of Scottish Hydro Electric Transmission Ltd's and SP Transmission Ltd's transmission licences.
 - Special Condition C8B (Restriction of revenue in respect of the NTS transportation owner activity and NTS system operation activity) of National Grid Gas Ltd's NTS licence.
 - Special Condition E16 (Disapplication of the Distribution Network Transportation Activity Revenue restriction) of the Gas Distribution Network Operator's licences.
 - Special Condition A4 (Duration of the charge restriction conditions) of the electricity DNO licences.
 - Amended Standard Condition BA (Charging Arrangements or Regulation of charging arrangements) of the IDNO licences.
 - Special Condition 1 (Charging of Gas Shippers – Relative Price Control).

Ofgem's website contains an electronic version of the Public Register. This includes the licence conditions of all network licensees (including the PECs). This can be found at <http://epr.ofgem.gov.uk/>.

4.3 Justification for reopening a price control

Regulation aims to provide incentives for network companies to strive for greater efficiency in order to meet, and where possible better, the terms of their regulatory settlements. In order to retain these incentives, we may not always be minded to reopen price controls in all cases where a PEC makes a formal request. Whilst we will consider any request that is made on its merits and expect that these will turn on their own particular facts, we are currently minded to consider requests for disapplication of price control terms only where⁶ the following conditions apply.

- It can be demonstrated that adequate provision is not provided by the existing price control settlement. This includes where provision is not already made for movement in risk. As noted, in setting a price control Ofgem seeks to provide a licensee with a revenue stream that is sufficient for it to meet its statutory and regulatory obligations if it is operating in an efficient manner.

And

- The cause of financial distress is largely due to factors beyond the control of PEC management. These might include: (i) instances where additional workload has arisen from new legislation that was not anticipated at the time of the last review; or (ii) generally poor financial market conditions that mean that an efficient PEC with an investment grade credit rating is unable to finance its activities based on the current price control settlement. It would be for the applicant PEC to set out the evidence and to persuade us that the causes of financial distress were exogenous. The applicant PEC would also be required to demonstrate that it had examined other routes to address the financial distress before seeking the disapplication of its price control terms.

And

- Re-opening the settlement could reasonably be expected to relieve the financial distress in a timely manner. We do not consider it would be appropriate to reopen a

⁶ In setting out these criteria, the Authority is not fettering its discretion in respect of the application or interpretation of the criteria in the circumstances of a particular case, or in respect of any additional criteria the Authority may identify as relevant in the circumstances of a particular case.

control unless there was a realistic prospect of reaching a definitive conclusion within the timeframe necessary to address the declining financial position of the PEC. To do otherwise may mislead investors and creditors and ultimately increase the risk to consumers in the event of insolvency.

And

- We would also consider the impact re-opening a settlement may have on consumers, network users and other interested parties. In reaching a final view on whether to re-open a settlement, we would consider whether to consult on the appropriate regulatory response where, for example, re-opening may have a significant impact on third parties or unintended consequences. This could mean that, notwithstanding that the above conditions are met, a decision not to re-open could be made on the basis of, amongst other matters, a significant impact and / or significant unintended consequences on third parties.

A price control reopening request can also be made by an energy administrator as part of the energy administration process. Where re-opening the settlement at the PEC's request at the pre-administration phase could not reasonably have been expected to relieve financial distress in a timely manner, but where there may be reason to believe that the PEC concerned is operating economically and efficiently, a request to re-open may be made by the energy administrator whilst the PEC is in energy administration. We will consider any request that is made, whether during the administration phase or before, on its merits.

In making a disapplication request in respect of deteriorating financial health we would expect a PEC, at a minimum, to:

- specify the revenue restriction conditions to which the disapplication request relates;
- provide a detailed explanation of the reasons why it requires a disapplication; and
- demonstrate what actions it has already taken to mitigate its financial distress.

4.4 Process for undertaking an interim review

We recognise that in many cases a PEC's financial health may deteriorate quickly and additional revenue may need to be accessed quickly. Therefore, in the event that a disapplication request / request for a reopener is submitted in relation to a case of deteriorating financial health we will seek to make a decision on such an application in a timely manner. Further, we expect PECs to contact us as early as possible to identify a case of declining health and any requirement for a reopener / disapplication request and to provide associated information to support a request in a timely manner.

The key stages involved in undertaking a review will be as follows:

- issue formal notice of review;
- obtain revised information from PEC;
- where appropriate, publish consultation on revised terms;
- publish final conclusions; and
- make changes to price control formula and to the licence (if appropriate).

5. Energy administration arrangements – process

This chapter provides guidance on the process that may be followed in response to a case of a PEC entering energy administration. In this regard, attention is drawn to the Rules that operate in England and Wales⁷, and the Rules that operate in Scotland⁸. Whilst similar principles apply, there are differences between the Scottish legal system and the system in England and Wales, which mean that the process for obtaining an Energy Administration Order is different. There are therefore differences in both the Rules and the Court forms. References to the 'Energy Administration Rules' in this document are intended to refer to the Rules in England and Wales, and those in Scotland.

5.1 Energy administration arrangements

The energy administration arrangements are designed to ensure that a qualified insolvency practitioner, i.e. an energy administrator, can be appointed to fulfil the regulatory obligations of the PEC. The energy administrator is tasked with continuing to maintain and develop, as an efficient and economical system, the network of the insolvent PEC during energy administration. By doing so the energy administrator ensures continuity of supply.

5.2 Key stages of the energy administration process

There are a number of stages in energy administration. These can broadly be summarised as follows.

Stage 1 – Applying for an energy administration order

In the first instance DECC, or GEMA with the consent of the DECC, would apply to the Court for an energy administration order. The energy administrator would only be appointed if, on hearing the application, the Court made the order.

There is a range of documentation that is required to be completed to appoint an energy administrator. Whilst similar principles apply, given that there are separate Rules for England and Wales on the one hand, and Scotland on the other, the documentation will differ depending on where the application is made.

Stage 2 – Providing information to the energy administrator

Ofgem would provide the energy administrator with any information it required to operate the PEC. This is likely to include information on its licence and the regulatory reporting requirements and other obligations of the PEC.

Stage 3 – Energy administrator manages the affairs of the PEC

The energy administrator would manage the affairs and property of the PEC with a view to achieving the objective of energy administration. The objective of energy administration is to ensure that the PEC's system continues to be maintained and developed as an

⁷ The Energy Administration Rules 2005 (No. 2483),
<http://www.opsi.gov.uk/si/si2005/20052483.htm>

⁸ The Energy Administration (Scotland) Rules 2006 (No. 772) (S.8),
<http://www.opsi.gov.uk/si/si2006/20060772.htm>

economical system and that ultimately it becomes unnecessary for the energy administration order to remain in force. The latter is achieved either when the PEC is rescued as a going concern or its assets are transferred to another party.

During energy administration DECC may provide loans, grants, guarantees or indemnities to the PEC for the purpose of achieving the objective of energy administration.

If the energy administrator is in a position to rescue the PEC then the process would proceed to Stage 5. If, however, the best outcome is to transfer assets to another company/companies then they would proceed to Stage 4.

Stage 4 – Expressions of interest and sale of a PEC

In the event that a PEC is unlikely to be rescued as a going concern then other companies may express an interest in purchasing the assets of the PEC. Ofgem would assess any issue associated with the sale and advise DECC accordingly. Issues that Ofgem would need to consider include licensing issues and any competition concerns, as discussed in Chapter 8.

If the transfer of assets is to proceed, appropriate licensing changes will need to be made and, where appropriate, adjustments to price control arrangements. However, we would generally not expect to make adjustments to the price control in the event of a sale because the buyer should be able to factor the current price control into the price that it offered.

This stage would run in parallel with Stage 3.

Stage 5 – End of energy administration process

The end of the energy administration process occurs with the rescue of the PEC as a going concern or the sale and transfer of its assets to another company.

In the event that there are outstanding costs from the energy administration process, these may be recovered by a shortfall direction of the Secretary of State⁹. Those costs will ultimately be passed on to consumers.

There are a range of documents that need to be completed to bring the energy administration arrangements to an end. As in the earlier stages, the documentation will differ depending on whether the application is made in a Court in England and Wales, or in a Court in Scotland.

⁹ The Secretary of State may make a shortfall direction under Standard Licence Condition C24 of the Electricity Transmission Licence (System Operator Standard Conditions) or under Special Condition C22 of National Grid Gas - Gas Transporter Licence in respect of the National Transmission System. These conditions were put in place by the Secretary of State under the powers contained in sections 168 & 169 of the Energy Act 2004. Standard Condition 15 of the Electricity Supply Licence and Standard Condition B19 of the Gas Shippers' Licences also contain provisions relating to Energy Administration shortfalls.

6. Energy administration arrangements – appointing an energy administrator

This chapter sets out the process to appoint an energy administrator.

6.1 Energy administrator

There are a range of qualified insolvency practitioners. In nominating an energy administrator key issues that would be considered would include, but not be limited to:

- previous relevant experience including in financial modelling, administration and insolvency; and
- knowledge of the UK gas and electricity network sectors and the energy administration regime under the Energy Act 2004 and associated Rules in England and Wales, and Scotland.

Prior to nominating an energy administrator, conflicts of interest will need to be considered. A number of the insolvency practitioners will have worked in some capacity, including in some cases as auditors, for the PEC concerned or an affiliate of that PEC. Prior to appointment as an energy administrator, the firms must furnish Ofgem or DECC, as appropriate, with a written statement detailing any prior professional relationship with the PEC in financial distress. The written statement will also provide details of the procedures that the firm has in place for dealing with conflicts of interest if they arise at a subsequent stage of an energy administration process. Where a consultant is an auditor of the firm experiencing financial problems then this would constitute an unresolvable conflict.

6.2 Documentation for appointing an energy administrator

The Energy Administration Rules identify a range of documentation that has to be completed and filed with the Court by an applicant in seeking an energy administration order and the appointment of an energy administrator. Notice of the application must also be served on various parties pursuant to the Rules. Reference should be made to the Rules that apply. This will depend on whether the application is made in a Court in England and Wales, or a Court in Scotland.

The applicant for an energy administration order will be either the Secretary of State, or GEMA with the consent of the Secretary of State. If the application is completed by GEMA it must include a statement that it is made with the consent of the Secretary of State.

6.3 Funding arrangements

Funding arrangements in administration will be estimated by the administrator and the PEC and will need to be agreed. The Energy Act 2004 sets out the roles of DECC and HM Treasury with regard to funding.

7. Energy administration arrangements – process of energy administration

This chapter sets out the key issues that will need to be addressed during an energy administration process when the energy administrator is responsible for the day-to-day running of the PEC.

7.1 Stabilisation period

The period immediately following the appointment of the administrator is generally referred to as the 'stabilisation period'. During the stabilisation period the energy administrator will ensure that the PEC's system continues to be maintained and developed as an efficient and economical system. Although it will vary from case-to-case, this stage should only last a matter of days. During this period the company will continue trading as normal.

There are a range of potential actions that an energy administrator may undertake in the stabilisation stage. While there will not be a direct role for Ofgem in a number of these areas, there are likely to be potential interactions. The potential actions an energy administrator may take include:

- seeking to optimise the cash position of the company in energy administration by taking a series of actions such as recovering overdue debts and revisiting the tax position;
- request to modify an existing price control either by seeking to reopen a control or requesting modifications to existing capital expenditure ("CAPEX") programmes;
- seeking clarity on the funding of energy administration arrangements.

In order to stabilise the financial position of a PEC the energy administrator will be seeking to understand the PEC's current financial position and the existing regulatory arrangements and may seek additional information from Ofgem. This may include information on the company's licence, its regulatory reporting requirements and other obligations of the licensee.

7.2 Core energy administration period

During the core period of the energy administration process the energy administrator will be responsible for the day-to-day running of the network business. The energy administrator will also consider issues associated with restructuring the PEC with a view to improving its financial health. As a result, the energy administrator may identify changes to price control terms or capital expenditure plans which may be raised with Ofgem for further consideration. In reviewing such options Ofgem would be expected to consider factors such as, but not limited to:

- whether the identified capital expenditure was non-critical;
- implications of that deferred expenditure for customers, e.g., future connections, network integrity;
- implications of that deferred expenditure for future expenditure;
- implications of changes to price control terms for the financial position of the PEC; and
- implications of any changes for the ability of the PEC to meet its licence obligations on an ongoing basis.

7.3 Ofgem’s financial monitoring process

Ofgem will continue its arrangements for monitoring the financial health of all PECs during an energy administration process. The process of monitoring will be identical to that during pre-administration, which is outlined in Chapter 3.

Ofgem will also continue to monitor the health of the specific PEC that enters energy administration. However, the monitoring arrangements for that PEC should include another level of detail to capture information on how any funding being provided is being spent.

Continuing the monitoring arrangements should enable Ofgem to gauge better the likely development of the energy administration process and the need for additional measures including:

- the likelihood of the PEC being rescued as a going concern in comparison with the requirement for a future sale; and
- the requirement for price control reopeners or adjustments to CAPEX spending plans.

7.4 Resignation of an energy administrator

One issue that Ofgem / DECC may have to deal with in the course of an energy administration process is the resignation of an energy administrator before the energy administration process is completed¹⁰. In the event that an energy administrator resigns it is required under the Rules to provide at least seven days notice to the Secretary of State and GEMA, amongst others. Reference should be made to the Rules that apply. This will depend on whether the application is made in a Court in England and Wales, or in a Court in Scotland.

Where an energy administrator resigns then the Secretary of State or GEMA with the consent of Secretary of State must appoint a new energy administrator. The process for appointing the new energy administrator is the same as that for appointing the original energy administrator (see Chapter 6).

¹⁰ Part 10 Rule 86 of the Rules applying in England & Wales and Part 8 Rule 54 of the Rules Applying in Scotland also contain provisions in respect of the death of an energy administrator during an energy administration process.

8. Energy administration arrangements – restructuring / sale

This chapter sets out the issues for Ofgem associated with either: (1) the restructuring; or (2) the sale of a PEC. This includes a consideration of legal, licensing and price control issues.

8.1 Restructuring of a PEC

Under the Energy Act 2004 there are two circumstances in which it becomes unnecessary for an energy administration order to remain in force. The principal circumstance is that the PEC is rescued as a going concern.

In order to rescue a PEC that has experienced significant financial distress, the energy administrator is likely to be required to restructure the PEC and its finances. Restructuring can take a number of forms including, but not limited to:

- debt restructuring through means such as renegotiating existing arrangements with creditors or arranging more favourable repayment terms;
- improving cash-flow through means such as renegotiating banking facilities;
- refinancing and identifying alternative funding sources; and
- operational restructuring if practicable.

The energy administrator leads the restructuring process. However, Ofgem will monitor the process with a view to ensuring that the restructured PEC is on a sound financial footing and is unlikely to experience similar financial problems to those which had resulted in it being placed in energy administration in the first instance. Ofgem will also seek to ensure that any changes brought forward as part of the restructuring process does not adversely impact on the existing licence obligations of the PEC.

Further, Ofgem may consider reopening a PEC's existing price control as part of a restructuring process. This may either be driven by Ofgem in response to changes in the PEC's forward looking investment requirements or risk profile, or be requested by the energy administrator as part of the restructuring solution. In the event that Ofgem considered and rejected a request for a price control reopener during the pre-administration phase then it would be unlikely that a reopener would be granted at this stage in the process. The exception may be if a price control reopener was not considered a realistic option in the pre-administration stage due to the settlement not being reasonably expected to relieve the financial distress in a timely manner. It may be the case that time factors in administration mean that a price control reopener may be a more viable option. We will consider any request that is made on its merits and expect that any case that may arise will turn on its own particular facts. The approach to reopening a price control is the same as set out in Chapter 4 of this document.

8.2 Sale of a PEC

In the event that the objective of energy administration will not be achieved by rescuing the PEC as a going concern then the PEC as a whole or the assets of that PEC may be transferred to another company or companies. The sale of a PEC could happen at an early stage in the decline of a PEC's financial health and thereby prevent the need for an energy administration process, i.e. a trade sale could take place. Equally the sale of a PEC could happen as part of an energy administration process.

There are a number of issues with the sale of a PEC's assets which are broadly the same before and during energy administration. These can be broadly divided into legal, price control, licensing and operational issues.

8.2.1 Legal

There are a number of powers contained in the Competition Act 1998 and the Enterprise Act 2002 that the Authority exercises concurrently with the Office of Fair Trading (OFT) that may be relevant to the sale of a PEC.

In the event that a PEC is sold the sale of a PEC could result in a merger with another party in the UK energy sector. There are two relevant regimes for assessing mergers involving firms in the gas and electricity sectors in the UK:

- Concentrations with an EU dimension which would be assessed by the European Commission under the European Community Merger Regulation ("ECMR"); and
- Mergers which only have a UK market dimension are assessed by the Office of Fair Trading ("OFT") and the Competition Commission ("CC") under the Enterprise Act 2002.

Ofgem's role is to advise the OFT in its role as decision maker under the Enterprise Act 2002 and as the formal advisor to the European Commission where mergers fall under the ECMR. The advice provided by Ofgem will usually be based on the information provided by the relevant parties, our existing knowledge and experience of the sector and analysis of the likely impact of the merger on competition. Ofgem's principal objective is to protect the interests of customers, present and future, and therefore the impact on customers will be central to that assessment. In the case of a PEC that has experienced deteriorating financial health, Ofgem would also consider the extent to which the sale would address these issues and would be likely to prevent the health of the merged PEC from deteriorating in the future.

If a merger raises significant issues, Ofgem may decide to issue a consultation paper setting out its initial views. Respondents would usually be provided with a short timeframe in which to submit any views.

In the event that the sale of the PEC did not constitute a merger, Ofgem would still expect to carry out analysis of the impact of the sale. Issues of particular interest to Ofgem would be the likely impact on network development and the extent to which the sale would address the issues which had caused the PEC financial problems in the first instance. Ofgem would provide these views to DECC to inform its decision on the sale.

In the event that a sale raised any particular issues Ofgem may also consider specific additional licence obligations to address those concerns.

8.2.2 Price control

The impact of the sale of a PEC, particularly if the sale is to an existing PEC can have advantages and disadvantages for consumers.

Consumers can benefit from mergers if the combined grouping generates efficiency savings or improvements in quality of service that are either greater than or are generated more quickly than those that would have been realised by the separate entities. However, each merger also reduces the number of independent groups operating or owning distribution companies and hence limits the role which comparisons between companies can play at or between price control reviews. To reflect these factors Ofgem may take the decision to reopen a price control in the event of the sale of a PEC.

In May 2002 Ofgem published a policy paper¹¹ setting out its position in dealing with the ongoing regulatory issues raised by mergers or comparable transactions. The paper was developed for the electricity distribution sector but the issues are equally relevant for the other network sectors. In particular that:

- an adjustment ("merger tax") to price control revenues may be considered in the event of consolidation in a network sector to reflect the potential detriment to consumers; and
- any efficiency savings that mergers generate should be passed back to the PEC as they arise through the price control review process.

The approach to reopening a price control would be the same as set out in Chapter 4 of this document.

8.2.3 Licensing

The Gas Act and the Electricity Act make it an offence to carry out certain activities unless licensed or exempt from the requirement for a licence¹². Ofgem can grant licences¹³ for a range of activities including gas transportation, electricity transmission and distribution and owning and operating a gas or electricity interconnector. The Application Regulations¹⁴ state the manner and form in which licence applications must be made. Ofgem can also consent to the transfer of an existing licence to another party.

¹¹ Mergers in the electricity distribution sector: Policy Statement - Ofgem, May 2002, www.ofgem.gov.uk/About%20us/enforcement/mergers/oft/Documents1/mergersandaquisitions%2048.pdf

¹² Gas Act 1986 s5, http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/cukpga_19860044_en_2#pt1-pb2-l1g8; and Electricity Act 1989 s4, http://www.opsi.gov.uk/acts/acts1989/ukpga_19890029_en_2#pt1-pb2-l1g4

¹³ Gas Act 1986, s7/s7A, http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/plain/cukpga_19860044_en#pt1-pb2-l1g11; and Electricity Act 1989 s6, http://www.opsi.gov.uk/acts/acts1989/ukpga_19890029_en_2#pt1-pb2-l1g6

¹⁴ The Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations 2007 (No.1971), http://www.opsi.gov.uk/si/si2007/uksi_20071971_en_1; and The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2007 (No.1972), http://www.opsi.gov.uk/si/si2007/uksi_20071972_en_1

The licensing requirements in the event of a sale of a PEC would depend on whether the sale of the assets included the licence, i.e. the sale of the legal entity which holds the licence. In the event that the whole PEC was sold then the existing licence would move across to the new owners and there would be no need to issue a new licence or to transfer an existing licence.

If the whole PEC is not sold then arrangements would have to be made for issuing a new licence or transferring an existing licence. Ofgem has published guidance on applications for gas and electricity licences¹⁵. The guidance document sets out the procedures that Ofgem would follow when assessing licence applications. Normal licence applications take six to eight weeks to process. However, where justified on the grounds of urgency, a licence can be issued more quickly. Ofgem will consult for a period of not less than two months on the proposed transfer¹⁶. In deciding whether to give its consent to a proposed transfer, GEMA will apply the same criteria as it would apply if the Authority were deciding whether to grant a corresponding licence to the transferee pursuant to section 7A(6) of the Electricity Act and section 8AA(6) of the Gas Act. In the case of gas transporters, a licensee may only transfer its licence with the prior written consent of the Secretary of State. This is set out in Standard Special Condition A45 of the Gas Transporters Licence.

Whether or not an existing licence is transferred, Ofgem may consider that a modification to an existing licence is required to address a specific issue with the sale of a PEC. In accordance with section 7A(7) of the Electricity Act 1989 and section 8AA(7) of the Gas Act 1986, GEMA is required to give the Secretary of State not less than 28 days' notice of any proposal to impose a modification condition. In the case of the Gas Act 1986 GEMA is also required to give the Health and Safety Executive (HSE) not less than 28 days' notice of any proposal to impose a modification condition. If, before the expiry of the time specified in a notice given to the Secretary of State under sections 7A(7) of the Electricity Act or 8AA(7) of the Gas Act, the Secretary of State directs the Authority not to impose the condition, then GEMA must comply with the direction.

8.2.4 Operational

There are a number of operational arrangements that need to be taken into consideration in the event of either the significant restructuring of the assets of an existing PEC or the sale of those assets to another PEC. A number of these are highlighted below.

Gas safety cases – HSE

The Gas Safety Management Regulations 1996 (GSMR) are concerned with the safe management of the flow of gas. Any new operator transporting gas in a network must comply with the GSMR. Regulation 3 of the GSMR requires a gas transporter to prepare a safety case. Under the regulations, the safety case must be prepared by a nominated emergency co-ordinator which must be submitted and accepted by the HSE before beginning operations. A gas transporter's safety case is required to demonstrate how they will meet the criteria for effectively managing the risk of a gas supply emergency.

¹⁵ Gas and electricity licence applications – Guidance – Ofgem, August 2007, www.ofgem.gov.uk/Licensing/Work/Documents1/Guidance.pdf

¹⁶ Gas Act 1986 s8AA(9), http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/cukpga_19860044_en_4#pt1-pb2-l1q15 and Electricity Act 1989 s7A(9)

Under Regulation 4(2), where a revision is proposed that would render a safety case “materially different” then the safety case or relevant parts of it should be resubmitted to the HSE for acceptance. An energy administrator may need to consider with the network emergency co-ordinator whether a revised safety case is “materially different”. Equally, in appropriate circumstances, the energy administrator may need to liaise directly with the Health and Safety Commission. Any such “materially different” changes should not be implemented until the new safety case (or parts) has been accepted by the HSE.

Network codes

There are a series of codes that determine the operational and governance arrangements for the gas and electricity networks. The key network codes are:

- Balancing and Settlement Code (BSC)
- Connection and Use of System Code (CUSC)
- Uniform Network Code (UNC)
- IGT Uniform Network Code (IGT UNC)
- Distribution Connection and Use of System Agreement (DCUSA)
- SO-TO Code (STC)
- Grid Code
- Distribution Code

PECs are generally required either to accede to or comply with these codes.

The requirement to comply with or accede to a code is generally determined by the network licence. Therefore, if a PEC is sold then the buyer will be required to meet the terms of the codes in line with its licence obligations.

However, in the event that a sale results in the breaking up of an existing network then there would be additional issues to be addressed. These issues are further considered in the following sections on the disposal of assets and specifically highlight the example of the sale of National Grid's Gas Distribution Networks (GDNs).

Disposal of relevant assets

There are conditions in the licences of PECs placing conditions on the disposal of relevant assets. The relevant conditions are:

- Standard Special Condition A27 of the Gas Transporter Licence (NTS and DN)
- Standard Condition B29 of the Gas Transporter Licence (IGT)
- Standard Condition B3 of the Electricity Transmission Licence
- Standard Condition 26 of the Electricity Distribution Licence

Under these conditions PECs are not permitted to dispose of or relinquish operational control of any transportation asset unless the PEC gives Ofgem not less than two months prior written notice along with an explanation of the circumstances of the disposal or the intentions of the party intending to acquire the assets.

Further, Ofgem can place conditions on the disposal of any assets to a new buyer thereby helping to ensure that the interests of consumers are protected under the new ownership structure.

Additionally, under both Standard Special Condition A27 of the Gas Transporter Licence (NTS and DN) and Condition B29 of the Gas Transporter Licence (IGT), where the assets concerned comprise a significant part of the independent system operated by the PEC, then the PEC is required to put in place a suitable alternative arrangement and notify the Secretary of State not less than 60 days prior to the proposed disposal of the assets.

One example of a significant disposal of assets was National Grid's sale of four of its GDNs. In the event of a similar break up of existing networks there would be a significant number of operational issues that would have to be considered which would include, but not be limited to:

- security of supply implications;
- impacts on existing codes and associated framework agreements;
- changes to the structure of panels that manage the governance of codes;
- changes to existing agency arrangements;
- allocation of roles and responsibilities between the new entity and the original asset owner; and
- other asset ownership issues.

Guidance on the approach to such issues in the case of the sale of National Grid's GDNs is set out in more detail in the Authority's decision paper¹⁷.

¹⁷ National Grid Transco – Sale of Gas Distribution Networks: Authority Decision – Ofgem, January 2005, <http://www.ofgem.gov.uk/Networks/GasDistr/otherwork/Documents1/9523-2105.pdf>

9. End of energy administration process

This chapter provides guidance on the process and issues associated with ending energy administration. It includes an overview of the issues involved in the sale of a PEC and the transfer of its assets to another party.

9.1 Outcomes signalling the end of energy administration

Section 155 of the Energy Act 2004 defines the circumstances when it becomes unnecessary for an energy administration order to remain in force, namely when:

- the PEC is rescued as a going concern; or, where this is not reasonably practicable,
- the assets of the PEC are transferred to another company.

At the end of the energy administration process the role of the energy administrator becomes redundant as the original PEC or a new PEC takes over the running of the financial affairs of the business.

9.2 Documentation for ending energy administration

There is a range of documentation that must be completed and filed with the Court by an applicant seeking to bring an energy administration to an end. Reference should be made to the Rules that apply. This will depend on whether the application is made in a Court in England and Wales, or in a Court in Scotland.

9.2.1 *Creditor's voluntary liquidation*

This is the procedure by which an agreement is reached with the creditors such that they can seek revised repayment terms and allow the business to continue as a going concern.

In the event that energy administration moves to creditors' voluntary liquidation then the energy administrator will send a notice to that effect to the registrar of companies.

9.2.2 *Dissolution*

Dissolution is the procedure that terminates the existence of a business. Reference should be made to the Rules that apply. This will depend on whether the application for dissolution is made in a Court in England and Wales, or in a Court in Scotland.

9.2.3 *Application to remove energy administrator*

In the event that an application is made to remove the energy administrator from office, the application should outline the grounds on which the request is made. The application should be served on the persons provided for in the Rules. Reference should be made to the Rules that apply, and this will depend on whether the application is made in a Court in England and Wales, or a Court in Scotland.

9.2.4 Application to replace an energy administrator

Where an application is made to replace an energy administrator then the same process applies for appointing the new energy administrator. Once again, reference should be made to the Rules that apply. This will depend on whether the application is made in a Court in England and Wales, or in a Court in Scotland.

9.3 Other issues

As set out in Chapter 8, Ofgem may decide to reopen the price controls to reflect the impact of the restructuring or sale of a PEC. The price control changes and other potential licence changes will be made at this stage and finalised before the new arrangements take effect.

10. Interactions with key stakeholders

In addition to the energy administrator there are a range of different parties that will be involved in a case where a PEC enters energy administration. These include other Government departments. This chapter sets out the details of how key Government departments will be involved in the energy administration process.

10.1 Government departments

10.1.1 Department of Energy and Climate Change (DECC)

DECC is responsible for managing network crisis issues and there is a significant role for DECC in any energy administration process. There will therefore be a requirement for significant and ongoing interaction between Ofgem and DECC in the event that a PEC faces financial distress. The need for interaction occurs at almost every stage of the process. The key interactions are as follows:

- determining whether DECC, or GEMA with the consent of DECC, applies to the Court for an energy administration order;
- addressing issues associated with the sale of a PEC;
- the criteria to be used to determine whether extending loans, guarantees, etc is appropriate; and
- discussing any 'shortfall direction' the Secretary of State proposes to make.

10.1.2 HM Treasury

The key issues for HM Treasury in the process are those associated with funding. The key stage in the process where Ofgem may need to interact with HM Treasury either directly or more likely indirectly (via DECC) is in providing consent for provision of financial support for companies in energy administration including grants, loans and indemnities (Energy Act 2004 – Sections 165-167; see Appendix 1).

10.1.3 Health and Safety Executive (HSE)

If underinvestment in networks persists then it could pose public safety issues.

The HSE is the statutory body responsible for regulating gas safety in Great Britain. Among other things it is responsible for ensuring that those involved with the transmission, distribution and storage of gas comply with the relevant legislation.

The two key pieces of legislation are as follows:

- Gas Safety (Management) Regulations 1996¹⁸
- Pipelines Safety Regulations 1996¹⁹

¹⁸ Gas Safety (Management) Regulations 1996 (No. 551), www.opsi.gov.uk/si/si1996/UKsi_19960551_en_1.htm

¹⁹ Pipelines Safety Regulations 1996 (No. 825), www.opsi.gov.uk/si/si1996/UKsi_19960825_en_2.htm

Under Regulation 4(2) of the Gas Safety (Management) Regulations where a revision is proposed that would render a safety case “materially different” then the safety case or relevant parts of it should be resubmitted to the HSE for acceptance. One issue that would constitute a material difference would be in the event of the sale of a PEC that would result in a change of operator or ownership or indeed a substantial restructuring of a PEC that resulted in significant changes to policies or procedures.

The HSE also enforces the Electricity Safety, Quality and Continuity Regulations 2002²⁰ (ESQCR) as amended by The Electricity Safety, Quality and Continuity Regulations 2006. The ESQCR specify safety standards and are aimed at protecting the general public and consumers from danger. There is no equivalent of the “gas safety case” for electricity under the ESQCR.

The key stages in the process where Ofgem may need to interact either directly or more likely indirectly (via DECC) with the HSE are as follows:

- at the earliest possible stage when a PEC experiences financial distress to confirm whether there are any potential operational issues;
- regular ongoing contact in the event that a potential operational issue is identified and mitigating measures are required to be taken; and
- in the event of the potential sale or significant restructuring of a gas network.

10.1.4 Pensions Regulator

A commercial issue which may have a bearing on the sale of a licensee is the treatment of any pension scheme that the existing licensee has in place. The basis of pension’s law is set out in the Pensions Act 2004²¹ and regulations made thereunder. The Pension Act 2004 contains provisions relating to the treatment of pension liabilities. Ofgem will seek to identify any pension issues at the earliest possible stage.

The Pensions Regulator is the body responsible for regulating work-based pension arrangements. Ofgem will liaise with the Pensions Regulator as required in responding to a case of financial distress.

²⁰ Electricity Safety, Quality and Continuity Regulations 2002(No. 2665), www.opsi.gov.uk/si/si2002/20022665.htm

²¹ http://www.opsi.gov.uk/Acts/acts2004/ukpga_20040035_en_1

Part 3: Appendices

Part 3 consists of a series of appendices that set out more detail on specific aspects of Ofgem's arrangements.

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Appendix 1 - Overview of relevant legal framework

This Appendix provides an overview of the key aspects of the Authority's legal powers relevant to energy administration. It includes details of the principal objective and general duties, the Insolvency Act 1986, the Energy Act 2004 as well as the financial ring fencing conditions. This Appendix is not intended to provide a comprehensive overview, and is not a substitute for reference to the relevant legal instruments (including, but not limited to, those referred to below).

A 1.1 Principal objective and general duties

The Authority's principal objective in carrying out its functions under the Gas Act 1986 and the Electricity Act 1989 is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. The implications of a network operator experiencing financial distress may directly impact consumers. Section 9 of the Gas and Electricity Acts set out the general duties of the licence holders. Section 9(2) of the Electricity Act and section 9(1) of the Gas Act requires the holders of network licenses to develop and maintain an efficient, co-ordinated and economical system of electricity transmission or pipe-line system for the conveyance of gas. Where their financial position deteriorates, network operators may struggle to invest appropriately to maintain and develop their networks. As a consequence, they may not be able to meet customers' demands for connections and energy transfers. If those conditions prevail overtime then there may be a threat to security of supply.

The Authority must have regard to a number of other factors in carrying out those functions, a number of which are relevant in circumstances where a licensee is facing financial distress. Most notably, the Authority has a duty to secure that licensees are able to finance their obligations under the Gas Act and Electricity Act. This does not mean Ofgem would be expected to provide regulatory relief to alleviate a licensee's financial distress in all circumstances. In circumstances of financial distress, Ofgem would need to consider the reasons why the licensee was in that position and whether it resulted from factors of the licensee's making or from factors beyond their control. One example of an action Ofgem has taken to secure licensees are able to finance their obligations was to introduce financial ring fencing aimed at protecting network licensees against financial pressures arising from elsewhere. These measures are discussed in further detail below.

The Authority must also have regard to the need to secure that, so far as it is economical to meet them, all reasonable demands for gas and electricity are met. Under circumstances of financial distress a licensee may not be able to adequately invest in its networks. This provides a threat to security of supply which would mean that reasonable demands for gas and electricity may not be met.

Subject to these considerations, the Authority is also required to carry out its functions in the manner it considers is best calculated to protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity. Section 3C of the Electricity Act 1989 and section 4A of the Gas Act 1986 contains provisions relating to Health and Safety. In electricity and gas, the Authority is obliged to consult the Health and Safety Commission about all electricity and gas safety issues. The Gas Act 1986 allows the Authority to make regulations for guaranteed standards of performance, with the consent of the Secretary of State, and to determine overall standards of performance for gas

transporters²². Guaranteed standards of performance set service levels that must be met in each individual case.

Overall standards of performance set minimum average levels of performance in areas where it is not necessarily appropriate to put in place guarantees for individual customers. These arrangements are a key balance to price control incentives to reduce costs and therefore provide consumers some protection. However, where a licensee experiences financial distress, its ability to invest in networks and to meet its required standards may be diminished. If underinvestment in networks persists then it could, in the case of gas transporters, pose public safety issues.

A 1.2 Insolvency Act 1986

The Insolvency Act 1986 sets out a procedure – administration – whereby a company that experiences financial distress may obtain a moratorium on the requirement to repay debts while an administrator is appointed. The administrator would be appointed under a court administration order and charged with attempting to restructure the company to which it is appointed so that the company may resume normal trading, or if this is impracticable within a reasonable timeframe, or if a better outcome could be thus secured (for creditors and members), selling the company or its assets. The principal role of the administrator under the Insolvency Act is to act in the interests of all of the creditors and to seek to rescue the company as a going concern.

The detailed provisions for the formal insolvency procedures of the Insolvency Act 1986 are set out in the Insolvency Rules 1986, as amended.

A 1.3 Energy Act 2004

An energy administration regime was established through primary legislation in the Energy Act 2004. Chapter 3 of the Energy Act 2004 (sections 154 to 171) contains provision for an energy administration regime for a 'protected energy company' (PEC). A PEC is a company which is the holder of a licence granted under section 6(1)(b) or (c) of the Electricity Act 1989 (transmission and distribution licences for electricity) or a licence granted under section 7 of the Gas Act 1986 (licensing of gas transporters).

The Energy Act modifies certain provisions of the Insolvency Act 1986. In particular, it defines the objective of energy administration as being, amongst other matters, to secure that the PEC's system is and continues to be maintained and developed as an efficient and economical system. This obligation should as a consequence also ensure continuity of supply. The Energy Administrator of a PEC must manage its affairs, business and property, and exercise and perform all his powers and duties, so as to achieve the objective of energy administration.

Under the provisions of section 156 of the Energy Act 2004, if a PEC becomes insolvent, the Secretary of State, or the Authority with the consent of the Secretary of State, may apply to the Court for an order to place the licensee into energy administration. Once in administration, the administrator is required under sections 158 and 159 to perform its duties so as to achieve the objective of energy administration. Section 155 sets out the objective of energy administration as being to secure:

- that the company's system is, and continues to be maintained and developed as, an efficient and economical system; and

²² The Gas Act 1986, Sections 33A to 33E,
http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/cukpga_19860044_en_1

-
- to try to rescue the company as a going concern or transfer its assets and licence to another company – the “successor company”.

Sections 165 to 167 of the Energy Act 2004 enable the Secretary of State to provide financial support, in the form of grants and loans, to companies in administration. It also sets out the arrangements for the loans to be repaid. If, either during or at the end of energy administration, the PEC is unable to repay these debts then the Secretary of State may make a ‘shortfall direction’ (see A1.4 below).

A 1.4 Cost Recovery Mechanism

Standard Condition C24 of the Transmission Licences, Special Condition C22 of the Gas Transporter Licence contain provisions enabling the Secretary of State to recover certain monies (“shortfall”) that may have been made to a PEC that encountered a shortfall while in energy administration²³. These conditions were put in place by the Secretary of State under the powers contained in sections 168 & 169 of the Energy Act 2004. The licence conditions require the licensees to modify their charges to recover the increased revenues from their customers. Ultimately, the costs are likely to be passed down the supply chain and recovered from energy consumers.

A 1.5 Energy Administration Rules

In exercising the powers conferred on him by section 159(3) of the Energy Act 2004 and section 411 of the Insolvency Act 1986, the Lord Chancellor made the Energy Administration Rules 2005²⁴ which came into force in October 2005 and apply to protected energy companies in England and Wales and the Energy Administration (Scotland) Rules 2006 which came into force in March 2006 and apply to protected energy companies in Scotland. The rules set out the detailed procedures governing how energy administration must be conducted. The rules cover all aspects of administration such as the appointment of an energy administrator, process of energy administration, ending energy administration and court procedure and practice.

A 1.6 Financial ‘ring fence’

One of the measures Ofgem has taken to safeguard against financial distress was to introduce “financial ring fence” licence conditions into the licences of network operators (with the exception of the gas and electricity interconnector licences) aimed at protecting them against financial pressures arising elsewhere in the Group and at ensuring that their financial resources are not exposed to inappropriate risks nor diverted to other purposes.

While introduced at different times, the licence conditions relating to financial ring fencing for the network operators were standardised in the licences determined by the Secretary of State pursuant to the Utilities Act 2000. In further developing the relevant licence conditions since 2000, Ofgem has maintained a standardisation approach with the aim of ensuring that the ring fence conditions were substantially the same in all energy network operator licences.

²³ Standard Condition 15 of the Electricity Supply Licence and Standard Condition B19 of the Gas Shippers’ Licences also contain provisions relating to Energy Administration shortfalls.

²⁴ The Energy Administration Rules 2005 (No. 2483),
<http://www.opsi.gov.uk/si/si2005/20052483.htm>

A 1.7 Provision of information to the Authority

All licences contain provisions requiring the licensees and their ultimate controllers to provide information in a manner and in the timeframe reasonably requested by the Authority. In the case of the network businesses the relevant conditions are Standard Condition 6(1)(c) of the electricity distribution licence, Standard Special Condition A26 of the gas transporters licence (DNs and NTS), Standard Condition 24 of the gas transporters licence (IGTs), Standard Condition B4 of the transmission licence and Standard Condition 4 of both the gas interconnector licence and electricity interconnector licence. In circumstances where we are aware that a licensee may have deteriorating financial health, we will write to the licensee to request additional information.

In addition, Standard Condition B7 of the transmission licence, Standard Condition 30 of the electricity distribution licence, Standard Special Condition A37 of the gas transporters licence (DNs and NTS) and Standard Condition 44 of the gas transporters licence require the licensees to provide an 'Availability of Resources Statement' confirming that the licensee has resources to properly and efficiently carry out its duties and that, in the opinion of their Directors, they have sufficient financial resources and financial facilities available to continue to carry out their activities for the next 12 months. This condition also applies to IGTs and IDNOs. At the last Transmission Price Control Review (TPCR) and the Gas Distribution Price Control Review (GDPCR) the requirement was added to those licences requiring the licensee to provide a forward looking cash flow statement for a year. The electricity distribution licences do not currently contain this clause but this may be introduced at DPCR5. There is no requirement for an 'Availability of Resources Statement' in the gas and electricity interconnector licences.

A 1.8 Competition Act 1998 / Enterprise Act 2002

There are a number of powers contained in the Competition Act 1998 and the Enterprise Act 2002 that the Authority exercises concurrently with the Office of Fair Trading (OFT) that may be relevant to the sale of a PEC.

In the event that a PEC is sold the sale of a PEC could result in a merger with another party in the UK energy sector. There are two relevant regimes for assessing mergers involving firms in the gas and electricity sectors in the UK:

- Concentrations with an EU dimension which would be assessed by the European Commission under the European Community Merger Regulation ("ECMR"); and
- Mergers which only have a UK market dimension are assessed by the Office of Fair Trading ("OFT") and the Competition Commission ("CC") under the Enterprise Act 2002.

Appendix 2 - The Authority's powers and duties

Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.²⁵

Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly²⁶.

The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them²⁷;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²⁸

Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed²⁹ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;

²⁵ entitled "Gas Supply" and "Electricity Supply" respectively.

²⁶ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

²⁷ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

²⁸ The Authority may have regard to other descriptions of consumers.

²⁹ or persons authorised by exemptions to carry on any activity.

-
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
 - secure a diverse and viable long-term energy supply.

In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation³⁰ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

³⁰ Council Regulation (EC) 1/2003,
http://ec.europa.eu/competition/publications/publications/modernisation_en.pdf

Appendix 3 - Network licensees and group owners

Table 1 – Network licensees

Interconnector licensees are not defined as protected energy companies (PECs), but are listed here for completeness.

Network Licensees	Category	Type of Licence
Electricity		
National Grid Electricity Transmission Plc	TO	Electricity Transmission
Scottish Hydro Electric Transmission Limited	TO	Electricity Transmission
SP Transmission Limited	TO	Electricity Transmission
Central Networks East Plc	DNO	Electricity Distribution
Central Networks West Plc	DNO	Electricity Distribution
EDF Energy Networks (EPN) Plc	DNO	Electricity Distribution
EDF Energy Networks (LPN) Plc	DNO	Electricity Distribution
EDF Energy Networks (SPN) Plc	DNO	Electricity Distribution
Electricity North West Limited	DNO	Electricity Distribution
Northern Electric Distribution Limited	DNO	Electricity Distribution
Scottish Hydro Electric Power Distribution Plc	DNO	Electricity Distribution
Southern Electric Power Distribution Plc	DNO	Electricity Distribution
SP Distribution Limited	DNO	Electricity Distribution
SP Manweb Plc	DNO	Electricity Distribution
Western Power Distribution (South Wales) Plc	DNO	Electricity Distribution
Western Power Distribution (South West) Plc	DNO	Electricity Distribution
Yorkshire Electricity Distribution Plc	DNO	Electricity Distribution
Energetics Electricity Limited	IDNO	Electricity Distribution
ESP Electricity Limited	IDNO	Electricity Distribution
Independent Power Networks Limited	IDNO	Electricity Distribution
The Electricity Network Company Limited	IDNO	Electricity Distribution
ECG (Distribution) Limited	IDNO	Electricity Distribution
EDF Energy (IDNO) Limited	IDNO	Electricity Distribution
Gas		
National Grid Gas Plc	NTS and GDN	Gas Transporter
Energetics Gas Limited	IGT	Gas Transporter
ES Pipelines Limited	IGT	Gas Transporter
ESP Connections Limited	IGT	Gas Transporter
ESP Networks Limited	IGT	Gas Transporter
ESP Pipelines Limited	IGT	Gas Transporter
Fulcrum Pipelines Limited	IGT	Gas Transporter
GTC Pipelines Limited	IGT	Gas Transporter
Independent Pipelines Limited	IGT	Gas Transporter
Quadrant Pipelines Limited	IGT	Gas Transporter
SSE Pipelines Limited	IGT	Gas Transporter
The Gas Transportation Company Limited	IGT	Gas Transporter
Utility Grid Installations Limited	IGT	Gas Transporter
Wyre Gas Transportation Limited	IGT	Gas Transporter
Caythorpe Gas Storage Limited	GT	Gas Transporter (Storage) ³¹

³¹ Companies in this category of Gas Transporter hold a modified GT licence but they don't transport gas to end customers. Rather their pipeline is used to transport gas from a GDN to storage cavities, for example.

INEOS Enterprises Limited	GT	Gas Transporter (Storage)
Severn Gas Transportation Limited	GT	Gas Transporter (Storage)
Star Energy Gas Storage Services Limited	GT	Gas Transporter (Storage)
WINGAS Storage UK Limited	GT	Gas Transporter (Storage)
Northern Gas Networks Limited	GDN	Gas Transporter (DN)
Scotland Gas Networks Plc	GDN	Gas Transporter (DN)
Southern Gas Networks Plc	GDN	Gas Transporter (DN)
Wales & West Utilities Limited	GDN	Gas Transporter (DN)
Interconnector		
BBL Company	ITC	Gas Interconnector
BGE (UK) Limited	ITC	Gas Interconnector
Interconnector (UK) Limited	ITC	Gas Interconnector
Premier Transmission Limited	ITC	Gas Interconnector
BritNed Development Limited	ITC	Electricity Interconnector
EirGrid Plc	ITC	Electricity Interconnector
Imera Hydragrid Limited	ITC	Electricity Interconnector
Imera Power Limited	ITC	Electricity Interconnector
Moyle Interconnector Limited	ITC	Electricity Interconnector
National Grid Interconnectors Limited	ITC	Electricity Interconnector

Table 2 – Group owners

Group Owners	Network Licensee
ABN Amro - Infrastructure Capital Equity Fund	ESP Electricity Limited ES Pipelines Limited ESP Networks Limited ESP Pipelines Limited ESP Connections Limited
Babcock and Brown Infrastructure Limited	The Electricity Network Company Limited GTC Pipelines Limited The Gas Transportation Company Limited Utility Grid Installations Limited
Berkshire Hathaway, Inc (89.5%)/ Other shareholders (10.5%)	Northern Electric Distribution Ltd Yorkshire Electricity Distribution Plc
Inexus Group Limited	Independent Power Networks Limited Independent Pipelines Limited Quadrant Pipelines Limited
North West Electricity Networks (Jersey) Ltd	Electricity North West Limited
Ecocentrogen Limited	ECG (Distribution) Ltd
E.ON AG plc	Central Networks West Plc Central Networks East Plc
Electricite de France S.A.	EDF Energy Networks (LPN) Plc EDF Energy Networks (SPN) Plc EDF Energy Networks (EPN) Plc EDF Energy (IDNO) Limited
Energetics Networked Energy Ltd	Energetics Electricity Limited Energetics Gas Limited
Iberdrola S.A.	SP Transmission Limited SP Distribution Limited SP Manweb Plc
INEOS Enterprises Limited	INEOS Enterprises Limited
MGN Gas Networks (UK) Ltd	Wales & West Utilities Limited
National Grid Plc	Fulcrum Pipelines Limited National Grid Gas Plc National Grid Electricity Transmission plc
PPL Corporation	Western Power Distribution (South Wales) Plc Western Power Distribution (South West) Plc
Scottish and Southern Energy Plc	Scottish Hydro Electric Power Distribution Plc Southern Electric Power Distribution Plc Scottish Hydro Electric Transmission Ltd SSE Pipelines Limited
Scottish and Southern Energy Plc (50%), Borealis Infrastructure Europe (UK) Ltd (25%), OTPPB Investments (U.K.) Ltd (25%)	Scotland Gas Networks Plc Southern Gas Networks Plc
Star Energy UK Onshore Ltd	Star Energy Gas Storage Services Ltd
Northern Gas Networks Holdings Limited	Northern Gas Networks Limited
Warwick Energy Ltd	Caythorpe Gas Storage Limited
Welsh Power Group Ltd	Severn Gas Transportation Limited
Wintershall Holding AG / OAO Gazprom	WINGAS Storage UK Limited
Wyre Gas Transportation Limited	Wyre Power Limited

Interconnectors – Group Owners

Group Owners	Network Licensee
Bord Gais Eireann - Irish Government	BGE (UK) Ltd
Gasunie BBL B.V. (60%), E.ON Ruhrgas BBL B.V. (20%), Fluxys BBL B.V. (20%)	BBL Company
National Grid Plc (50%) / TenneT (50%)	BritNed Development Limited
Northern Ireland Energy Holdings Ltd	Premier Transmission Limited Moyle Interconnector Limited
Oceanteam ASA (65%), Imera Power (35%)	Imera Hydragrid Limited Imera Power Limited
La Caisse de dépôt et placement du Québec, CDP Investissements Inc, Conoco Phillips (UK) Limited, Distrigas S.A., Electrabel S.A., ENI International BV, E.ON Ruhrgas AG, OAO Gazprom	Interconnector (UK) Limited
Minister for Communications, Energy and Natural Resources	EirGrid Plc
National Grid Plc	National Grid Interconnectors Ltd

Appendix 4 - Monitoring arrangements

A 4.1 Monitoring compliance

The network licences set out a range of information that the PECs are required to provide to Ofgem. The conditions also determine when that information is required to be provided. The reporting requirements are collectively referred to as the “compliance” reporting requirements. We monitor the PECs against the compliance reporting requirement and will notify a PEC where information is not provided in line with the timescales set out in its licence.

The compliance reporting requirement can be separately broken down into cost, revenue and quality of service reporting requirements. Each of these areas is discussed below.

A 4.2 Cost and revenue reporting

We have detailed cost and revenue reporting arrangements in place. The purpose of those arrangements is to provide a framework for the collection and provision of accurate and consistent cost information from the PECs. To facilitate the provision of this information, Ofgem developed Price Control Cost Reporting Rules, Instructions and Guidance for each of the areas. Those arrangements are also supported by annual visits to the transmission and distribution licensees to follow up on the reporting submissions.

The reporting requirements are set out in the following licence conditions:

- Standard Licence Condition 48 (SLC 48) of the electricity distribution licence provides a framework for the collection of cost information from the DNOs and IDNOs.
- Standard Licence Condition 47 (SLC 47) of the electricity distribution licence provides a framework for the collection and provision of revenue information from the DNOs and IDNOs.
- Standard Special Condition A40 (SSC A40) of the gas transporter licence (DN) sets out the cost reporting requirements for the GDNs.
- Special Condition E20 of the gas transporter license provides a framework for the collection of revenue information from the GDNs.
- Standard Licence Condition B15 (SLC B15) of the electricity transmission licence provides a framework for the collection and provision of both cost and revenue information from the electricity transmission businesses.
- Standard Special Condition A40 (SSC A40) of the gas transporter licence (NTS) sets out the cost reporting requirements for NGG.

The latest versions of the Reporting Rules, Instructions and Guidance for the network companies are available on Ofgem’s website.

A 4.3 Quality of service reporting

There are also quality of service reporting requirements on the gas and electricity protected energy companies. These require those companies to provide information that allows Ofgem to monitor and publicise the quality of service provided by those companies. This creates an incentive for those companies to improve their quality of service and also helps to identify areas where further regulatory action may be required.

The requirements to provide quality of service information are set out in the following licence conditions:

- Standard Special Condition D9 (Quality of Service) of the gas distribution licence.
- Standard Licence Condition 49 (Quality of Service Incentives Scheme and Associated Information) of the electricity distribution licence.
- Standard Licence Condition D3 (Transmission system security standard and quality of service) of the electricity transmission licence.

A 4.4 Monitoring market indicators

Separately, we monitor general market indicators such as share prices, credit ratings and other publicly available information with a view to establishing a broader picture of financial performance and health. Therefore, in addition to the review of the companies' annual reporting requirements, we collect and assess some information on a more frequent basis. That information includes:

- bonds issued;
- credit ratings;
- sub-investment grade ratings; and
- refinancing requirements.

Appendix 5 - Financial ring fence

This Appendix sets out details of the financial ring fence arrangements. It outlines the purposes of those arrangements, the licence conditions by which they are implemented and the approach to monitoring compliance with, and where appropriate taking enforcement action for breaches of the financial ring fence conditions.

A 5.1 Overview of licence conditions

The key licence conditions and their purposes are as follows:

Disposal of relevant assets – requires the licensee to provide written notice to the Authority of any proposed disposal of operational control of any assets forming part of its network.

The purpose of this condition is to prevent a licensee relinquishing control of any asset that may be critical to the operation of that network without making Ofgem aware of it and giving us the opportunity to prevent the disposal if it does not serve the interests of consumers and network users.

Availability of resources – requires the licensee to ensure it has sufficient resources to carry on its licensed activities and to submit a report to the Authority annually, supported by the licensee's external auditors, confirming availability of financial resources. The condition also prevents the licensee from making or paying any dividend that would cause it to be in breach of its financial ring fence conditions at any future time.

The purpose of this condition is to ensure that a PEC always has at its disposal the resources to maintain and develop an efficient, economic and coordinated system. This condition provides us with crucial information for monitoring purposes.

Restriction on activity and financial ring fencing – requires the licensee not to conduct any activities other than those of its core business, subject to certain exceptions and specific limitations on the turnover and investment of permitted non-core activities. It also requires the licensee not to enter into an agreement incorporating a cross-default obligation without consent of the Authority.

The purpose of this condition is to prevent a licensee assuming material risks that are unrelated to its regulated activities and which may jeopardise its financial position in the event of an adverse outcome. Ofgem's power under this condition stems from discretion to withhold granting consents unless a licensee is protected from the risks associated with certain activities.

Credit rating – requires the licensee to maintain an investment grade credit rating.

The purpose of this condition is to ensure that licensees finance themselves and manage their operations in an efficient manner and by doing so ensure that they maintain ready access to sources of liquidity and capital on reasonable terms. Where a licensee experiences a reduction in its investment grade status it may trigger cash lock-up provisions under the indebtedness condition. This is discussed below.

Indebtedness – requires the licensee not to incur any indebtedness nor create any security, nor guarantee any liability of another person, other than on certain specified terms and for a permitted purpose, or otherwise with the consent of the Authority. It also provides for a cash lock-up in certain circumstances between the licensee and its affiliates.

The purpose of this condition is to ensure that a licensee only assumes liabilities relating to the conduct of its own business and activities and does not become exposed to risks that may jeopardise its financial position outside of those activities. The cash lock-up provisions ensure that the licensees conserve cash and other sources of value when its investment grade credit rating is jeopardised. Again Ofgem's powers under this condition stem from discretion to withhold granting consents in relation to the additional liabilities that the licensee may assume and in relation to its transactions with affiliates.

Undertaking from ultimate controller – requires the licensee to obtain an undertaking from its parent company and any other ultimate controllers that they will refrain from taking any action which may cause the licensee to breach its obligations under the Gas Act or the Electricity Act or its licence.

The purpose of this condition is to prevent a holding company or other ultimate controller from using its influence to cause the licensee to act inconsistently with the requirements of its licence and statutory obligations including most notably its requirement to maintain and develop an efficient system, and also the other ring fencing conditions. It also enables Ofgem to take action to prevent any repeated attempts of this nature.

Appendix 6 - Existing price control arrangements

This Appendix sets out details of the existing price control arrangement including timescales and links to key documentation.

A 6.1 Price controlled companies

Price controls are set for:

- the four transmission owners (Transmission Price Control Review – TCPR);
- fourteen electricity distribution networks (Distribution Price Control Review – DCPR); and
- eight gas distribution networks (Gas Distribution Price Control Review – GDPCR).

A 6.2 Relative price controls

As independent operators neither Independent Gas Transporters (IGTs) nor Independent Distribution Network Operators (IDNOs) are subject to full price control arrangements. Rather both are subject to relative price controls (RPC).

Under RPCs the level and structure of charges levied by the independent operator are subject to control by capping charges to an equivalent charge for the host operator. In gas, the IGTs are subject to a pre-determined floor and ceiling. The levels of the floors and ceilings are defined relative to the expected path of the host operator charges. There is no floor and ceiling for the IDNOs.

In the case of IGTs, charges are capped to the relevant GDN equivalent charge. A separate floor and ceiling applies for each of the eight distribution networks. In the case of IDNOs the price the IDNO can charge is linked to the incumbent DNO to which they are connected.

A 6.3 Timeframes of the current price controls

Ofgem has generally set price controls for the relevant network licensees for a period of 5 years (with the exception of IGT and IDNO controls).

The current review periods are as follows:

TCPR	1 April 2007 – 31 March 2012
DCPR	1 April 2005 – 31 March 2010
GDPCR	1 April 2008 – 31 March 2013
IDNO (RPC)	From 1 April 2006
IGT (RPC)	From 1 January 2004

A 6.4 Key documentation

The TCPR Final Proposals can be found at:

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR4/ConsultationDecisionsResponses/Documents1/16342-20061201_TPCR%20Final%20Proposals_in_v71%20%20Final.pdf

The DCPR Final Proposals can be found at:

<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf>

The GDCPR Final Proposals can be found at:

<http://www.ofgem.gov.uk/Networks/GasDistr/GDPCR7-13/Documents1/final%20proposals.pdf>

The distribution network (DN) revenue restrictions for all IGTs are set out in Special Condition 1 of their licences. Final proposals for IGTs can be found at:

http://www.ofgem.gov.uk/Networks/GasDistr/IGTReg/Documents1/3946-Decisiondoc_IGT_Final_Proposals.pdf

The charging arrangements for IDNOs are set in standard licence conditions (SLC) BA1 of their licences. The decision document outlining the RPC arrangements for IDNOs can be found at:

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/IDNOs/Documents1/11186-17605.pdf>

Appendix 7 - Glossary

A

Administration

A mechanism for dealing with an insolvent company whereby a qualified insolvency practitioner is charged with attempting to restructure the company so that it may resume normal trading.

The Authority (Ofgem)

Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by Section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain.

C

Capital Expenditure (Capex)

Expenditure on investment in long-lived transmission assets, such as gas pipelines or electricity overhead lines.

D

DECC

Department of Energy and Climate Change.

Distribution Network Operators (DNOs)

Holders of electricity distribution licences. Licences are granted for specified geographical areas. There are fourteen licensed distribution areas.

DPCR 4

The price control review for the electricity distribution network operators conducted in 2003 & 2004. The resulting price control covers the years 2005 to 2010.

E

Enterprise Act 2002

The Act made a number of important reforms, designed to crack down on abuses that harm consumers and fair-trading businesses alike and thus encourage productivity and enterprise. Included in the Act are provisions relating to market investigation references, super complaints and the enforcement of consumer legislation.

G**Gas Distribution Network (GDN)**

GDNs transport gas from the National Transmission System to final consumers and to connected system exit points. There are currently eight GDNs in Great Britain which comprise twelve local distribution zones.

Gas Distribution Price Control Review (GDPCR)

The review of the price control applying to gas distribution networks. The last review took place in 2007 and the resulting price control covers the years from 2008 to 2013.

GB Transmission

The system of high voltage electric lines providing for the bulk transfer of electricity across Great Britain.

Gearing

Ratio of a company's level of long-term debt to its equity.

H**Health and Safety Executive (HSE)**

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

I**Independent Distribution Network Operators (IDNOs)**

Holders of electricity distribution licences which own and run networks embedded in the DNO networks.

Independent Gas Transporters (IGTs)

Holders of gas transporter licences which develop operate and maintain local gas transportation networks.

Insolvency

Where a company's liabilities exceed the value of its assets and/or it is unable to pay its debts as they fall due.

N**National Transmission System (NTS)**

National Grid's high pressure gas transmission system. It consists of more than 6,400 km of pipe carrying gas at pressures of up to 85 bar (85 times normal atmospheric pressure).

O[Ofgem](#)

See definition of the Authority.

[Offshore electricity transmission operators \(OFTOs\)](#)

Offshore electricity transmission operators will be required to transmit electricity from offshore renewable generators to customers via the onshore transmission and distribution networks.

P[Protected energy company \(PEC\)](#)

Under The Energy Act 2004, a PEC is a network licensee that holds a licence granted under

- a) section 6(1)(b) or (c) of the 1989 Act (transmission and distribution licences for electricity); or
- b) a licence granted under section 7 of the Gas Act 1986 (licensing of gas transporters).

R[Reopener](#)

A process to re-set revenue allowances (or the parameters that give rise to revenue allowances) under a price control before the scheduled next formal review date for the relevant price control.