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Dear Susan

**Energy Networks ring fence review – Call for input**

Ofgem announced its Call for Input on the ‘Energy Networks ring fence review’ 18 September 2024. This document sets out our response on behalf of SSEN Transmission and SSEN Distribution (collectively referred to SSEN throughout our response) and is endorsed by the SSE plc Group. This is supplementary to the Energy Networks Association’s (ENA’s) response submitted on behalf of GB electricity DNO and TO members<sup>1</sup>.

SSEN agree with Ofgem that ensuring a financially resilient energy sector is in customers’ interests. As outlined in Ofgem’s Call for input ‘The ring fence is a key component of our financial resilience measures, which more broadly seek to ensure that licensees have sufficient financial safeguards or headroom so that they can avoid and/or manage the risk of financial distress.’ Given the stated significance, the impact of any changes to the existing ring-fencing framework are of profound importance to the stability and operation of regulatory price controls. In line with the ENA’s response, we also believe Ofgem’s proposal to amend the existing ring-fence arrangements raises the following concerns:

1. Ofgem has frequently and robustly reviewed and updated the ring fence arrangements that apply to energy networks over the decades that they have been in place. Arrangements implemented by other regulators and for other sectors have not been as robust. The fact that no energy network failures have occurred despite recent economic and energy market challenges should give Ofgem comfort that its approach to date has been successful.
2. Ofgem already has a suite of robust arrangements in place. Companies take their obligations very seriously. Ofgem has recently reviewed those arrangements, amended reporting rules and proposes to introduce new, even more stringent arrangements for the next price control period.

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<sup>1</sup> ENA response to Ofgem’s Ring Fence Review : energy networks call for input

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3. There is no evidence to justify introducing any of Ofgem’s suggested “higher intervention approaches”. These would inappropriately increase regulatory burden, increase the cost of capital, negatively impact financeability or investability or, in some cases, might even precipitate financial distress. It would be counter to the principles of Better Regulation to implement such disproportionate or untargeted measures.
4. If Ofgem has concerns that were not addressed in its recent SSMD, it should undertake a detailed review. This review should analyse the impact of available options in detail and, if demonstrated to be necessary, propose a proportionate and targeted approach to address any concerns identified. Ofgem should not enter such a review with a pre-conceived assumption that changes to requirements must result from such a review.
5. Financial resilience cannot be considered in isolation to financeability and investability. Current energy transformation activities mean that networks’ need to attract sufficient finance is more important than ever. Any detailed review must take account of the interaction with the price control policies that the ring fence arrangements are designed to co-exist with. A number of Ofgem’s proposed RIIO-3 policies are more likely to precipitate financial distress amongst energy networks than any perceived shortcoming in the ring fence arrangements.

Additionally, and in some instances expanding on the points above, SSEN would like to reiterate the following points raised in response to Ofgem’s consultation on ‘Proposed Modifications to the Regulated Financial Performance Reporting Template and guidance for RIIO-2’ (2024)<sup>2</sup>.

### **Principles of Better Regulation**

It is important Ofgem consider the principles of Better Regulation when implementing any change in the regulatory framework. The key principle that applies in this context is the Proportionality principle where regulators should intervene only when necessary and should be appropriate for the risk posed. Additionally, the Accountability principle is that regulators should be able to justify decisions and be subject to public scrutiny. Other principles around Transparency and Targeting of regulatory interventions are also key and should not be ignored. For example, regulation should be kept simple and user friendly and should be targeted on a specific problem or requirement.

As mentioned in Ofgem’s Call for Input, ‘...licensees have weathered the financial crisis and more recent volatility in commodity markets relatively unscathed.’ We believe there is no evidence to justify introducing any of Ofgem’s suggested “higher intervention approaches”. It would be counter to the principles of Better Regulation to implement such disproportionate or untargeted measures.

### **Existing Financial Reporting is more than Sufficient**

As part of the evolution of RIIO-2, we accepted that there are certain circumstances in which enhanced financial resilience reporting or measures may be appropriate. These have been reflected in the license conditions for regulated networks and Ofgem has not set out why these conditions are not sufficient to address financial resilience concerns of the regulator. This appears to us to be a reaction to the emerging issues widely reported within the UK water sector and not an issue we have experienced nor anticipate emerging within regulated energy networks. The financial resilience and performance issues arising within

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<sup>2</sup> SSEN’s response to Ofgem’s Call for Input on the proposed modifications to RFPR & Guidance

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the UK water sector are complex and if the proposed measures are designed to prevent such issues emerging in electricity networks, this approach would represent an over simplification to introduce additional financial resilience requirements without justifying fully why existing license and ring-fence obligations are insufficient.

There are already a number of protections in place such as requirements around Availability of Resources (AoR), Viability Statements, and conditions associated with investment grade credit rating. There are also obligations such as Ultimate Controller requirements and regulatory mechanisms Ofgem is exploring in RIIO-3 regarding enhanced financial resilience reporting. All of these measures should be sufficient to provide transparency in financial resilience reporting. At most, Ofgem should deploy appropriate tests to ensure regulatory intervention is only invoked in certain circumstances where current metrics gives the regulator cause for concern or provides an indication of future risk. The blanket policy to introduce additional requirements across the board falls short of the principles of Better Regulation as it triggers an additional regulatory burden regardless of the risk or concerns around financial resilience.

### **Disproportionate Disclosure Requirements**

- **Rationale for requirements is not clear**

Ofgem has frequently and robustly reviewed and updated the ring fence arrangements that apply to energy networks over the decades that they have been in place. SSEN take those obligations very seriously. Ofgem has not provided sufficient rationale in explaining their intentions for the significantly increased requirements.

- **Unpredictable and unreasonable disclosures compromise investability in the sector**

The energy system is undergoing major transition to enable net zero targets. Ensuring the investability of the industry is therefore more critical than ever. Enhanced and extended disclosure requirements may signal that investments in the regulated energy sector will become more burdensome and may be misinterpreted by the stock market and wider investors. This could indicate an increased risk of investment and could be viewed as a reactive response to recent and widely reported recent events in the UK water industry. This ambiguity is particularly unhelpful at a time when Ofgem itself recognises the clear need to demonstrate investability in UK energy infrastructure, as highlighted in the RIIO-3 Sector Specific Methodology Consultation.

- **Increased financial resilience requirements are disproportionate, imprecisely defined, and burdensome**

In line with the ENA's and SSEN's response to the RFPR RIG's consultation, we believe that some of the increased disclosure requirements are disproportionate. The introduction of unclear and disproportionate reporting requirements contradict Ofgem's primary goal of simplifying pricing control systems.

Furthermore, such unclear and unnecessary reporting requirements will only worsen the already extremely stretched resourcing challenged associated with regulatory reporting over the coming periods due to dual operation of RIIO-2 and RIIO-3 reporting basis for Gas Distribution Networks and Transmission Operators, as well as the first round of RIIO-2 basis reporting for Distribution Network Operators. Ofgem must therefore, reassess the information it intends to require to ensure that the industry is able to efficiently streamline its activities to rise to the challenge of delivering a suitable future state network for the benefit of our customers.

- **Sufficient statutory disclosures already exist**

Companies are bound by legal and regulatory frameworks, including the Companies Act 2006, which establishes safeguards to ensure that dividends are declared responsibly without compromising a company's financial health. Directors are required to exercise due diligence and consider the long-term impact on the company's solvency, liquidity, and overall viability as part of their duty to promote the success of the company before recommending or approving dividends and indeed, could be held personally liable should they fail to adhere to the codified duties across company and related legislation and have regard to a variety of factors identified in legislation and common law. The UK Corporate Governance Code also emphasises the importance of maintaining a balance between returning value to shareholders and retaining earnings for future growth and unforeseen challenges. Robust risk management processes and comprehensive financial assessments are integral to these protective measures, helping companies avoid excessive payouts that could jeopardize their ability to navigate economic uncertainties and sustain resilience over time.

Our dividend policy is based on a number of factors outlined in both statutory and governance requirements that the Board of Directors considers and gives due regard. This includes but is not limited to delivering on our Business Plan, maintaining our investment grade credit rating, and providing an appropriate return to shareholders alongside the stated Companies Act considerations which must be considered in good faith by all directors. As we have set out in our letter, there are already obligations on the financial resilience of regulated energy networks and conditions in which trigger enhanced reporting. Ofgem already has the powers to intervene in those situations and the blanket application of extensive regulatory reporting within and beyond the regulatory ring fence is disproportionate and risky.

### **Summary**

As highlighted above and in line with the ENA's response we disagree that any modifications are required to the current ring-fence framework. There are already measures in place within the licence for enhanced financial resilience reporting and options 2 and 3 would be disproportionate in this regard. The principles of Better Regulation should be considered when proposing modifications to regulatory reporting. Careful consideration should also be given to the regulated sector as a whole. For example, Ofgem cannot review nor enhance the current framework without also taking into consideration Offshore Electricity Transmission Operators (OFTO's) and Independent Distribution Network Operators (IDNO's). The current ring fencing licence obligation only applies to IDNOs that are vertically integrated and not all IDNOs. For fairness, we recommend that Ofgem considers creating a more level playing field where any licence obligations on financial reporting apply to all IDNOs equally.

We believe Ofgem has sufficient regulatory reporting requirements in place within the licence for financial resilience monitoring therefore our preferred option would be option 1 – to maintain the existing approach.

Yours sincerely,



Maz Alkirwi

**Finance Director**

## Appendix: Our Response to Ofgem's Specific Questions in the Call for Input

1. Have we identified the issues and challenges network companies are facing accurately? (Yes/No)
  - a. No – We see Ofgem's identification to be a reaction to the emerging issues widely reported within the UK water sector and not an issue we have experienced nor anticipate emerging within regulated energy networks. The financial resilience and performance issues arising within the UK water sector are complex and if the proposed measures are designed to prevent such issues emerging in electricity networks, this approach would be an over simplification to introduce additional financial resilience requirements without justifying fully why existing license and ring-fence obligations are insufficient.
2. Are there any other issues that may pose a threat to the regulatory ring fence that we should consider?
  - a. We believe the existing framework and rules are sufficient as demonstrated by the financial strength of the sector and responsible financial management by network companies. The threat of changing the rules at this stage given the nature of the enhanced rules is they are misinterpreted as being anti-investment. At a critical time of much needed capital in the sector to deliver the transition to NetZero, this would be harmful to consumers with no benefits accruing to them from the changes.
3. Are there any weaknesses within the current ring fence conditions that we should consider?
  - a. No - Ofgem has frequently and robustly reviewed and updated the ring fence arrangements that apply to energy networks over the decades that they have been in place. Arrangements implemented by other regulators and for other sectors have not been as robust. The fact that no energy network failures have occurred despite recent economic and energy market challenges should give Ofgem comfort that its approach to date has been successful.
4. Which would be your preferred option of the three outlined and why?
  - a. Option 1 – Maintain existing approach. Reasons outlined in main response above.
5. What are your views on the three options outlined and the associated benefits and risks of each?
  - a. We noted above, we see no benefits or indeed an impact assessment by Ofgem that would justify a change in the rules. Should these enhanced rules be implemented, it is likely to lead to costs to consumers through concerns around investability by investors particularly given the negative market sentiment in the UK Water sector affecting UK regulated sectors generally.
6. Tell us if you have suggestions on how we can improve our proposed options.
  - a. Further engagement with DNO and TO members to allow greater discussion around the appropriateness of any possible changes to the existing ring-fence framework.
7. Tell us about any alternate options we should consider
  - a. Potential changes to future price controls must be carefully considered in detail, and robustly tested in the context of the wider price control package. Future price control packages will need to consider the significant increase in investment and the challenges of moving to a cleaner, secure, and affordable energy system, and how this will ultimately be funded by the GB public. There is limited need to include any further options than is currently in place.