Decision

# Energy Networks Ring-fence Review – Licence Modifications

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On 1 July 2026 we published our *Energy Networks Ring-fence review statutory consultation*, with a response deadline of 12 August 2026.[1]

This document states our decisions following our review of the feedback we received from the statutory consultation.

[1] https://www.ofgem.gov.uk/consultation/energy-networks-ring-fence-review-statutory-consultation

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# Foreword

Energy networks are natural monopolies that provide essential services to consumers and underpin the wider economy. Effective regulation is therefore critical to ensure these companies operate efficiently, remain financially resilient, and deliver reliable services at a fair cost. At the same time, a stable and predictable regulatory framework is essential to support investor confidence and enable the significant long-term investment required across the sector.

The environment in which networks operate continues to evolve. Increasingly complex corporate structures, growing investment requirements and the scale of the energy transition all reinforce the need for a robust and forward-looking regulatory framework. In this context, the network ring-fence plays a central role in protecting consumers while maintaining a stable and investable sector. It helps ensure that licensed network companies remain financially resilient, maintain appropriate independence and continue to provide essential services, while limiting exposure to risks arising elsewhere within corporate groups.

Over the course of this review, we have engaged extensively with stakeholders. That engagement has helped shape the final package of licence modifications. In a number of areas, we have amended our proposals to provide greater flexibility, reduce unnecessary prescription and better reflect the different governance structures that exist across the sector. At the same time, we have remained focused on the core objectives of strengthening financial resilience, improving transparency and ensuring appropriate oversight of matters that could affect the long-term resilience of regulated businesses.

The decisions set out in this document reflect that balance. The measures will strengthen the existing ring-fence framework while remaining proportionate and targeted. In many cases, they do not restrict legitimate business activity but instead improve transparency, governance and the information available to Ofgem on matters that may affect consumers and the resilience of regulated entities.

A resilient and well-governed network sector benefits both consumers and investors. These decisions will help ensure that the regulatory framework remains fit for purpose, supporting confidence in the sector and providing a stable foundation for the investment needed to deliver secure, reliable and affordable energy in the years ahead

**Steve McMahon**

**Director – Financial Resilience and Controls**

# Executive summary

Further to our statutory consultation on the Energy Networks Ring-fence review and having carefully considered stakeholder responses, we have made a number of changes to the proposals consulted on, including the non-distributable reserves measure, SIDs measure and Electricity Transmission (ET) independence proposal, to improve proportionality and clarity whilst maintaining our underlying policy objectives. We have decided to:

- Require licensees to notify Ofgem before converting non-distributable capital or reserves into distributable reserves. Ofgem will have a defined period to review and, where necessary, object to the proposed alteration. If Ofgem does not object, the alteration may proceed;
- Implement the RIIO-3 ring-fence modifications in the Electricity Distribution (ED) sector now, rather than waiting until the start of ED3;
- Extend compliance and distribution certificates to cover all ring-fence and financial resilience conditions, subject to the existing materiality threshold;
- Require a sufficiently independent director, together with another director, to sign specified financial resilience submissions and asset-disposal notifications, but not published rating reports;
- Require a sufficiently independent director to make representations on chair and executive remuneration, while allowing flexibility for different corporate governance arrangements; and
- Not introduce the proposed network-independence condition for ET licensees, as existing licence provisions already provide relevant protections.

These decisions will strengthen regulatory oversight, independent challenge and the early identification of financial risks, while maintaining a proportionate and investable regulatory framework that supports the long-term interests of consumers.

# 1. Introduction

1.1 On 1 July 2026 we published our Energy Networks Ring-fence review statutory consultation following several publications and extensive engagement with stakeholders.

1.2 This document states our decisions following our review of the feedback we received from the statutory consultation.

1.3 In sections 2 to 11 below, we set out our licence modification decisions alongside the reasons for and effects of those modifications. In these sections we summarise the stakeholder responses to the statutory consultation and provide Ofgem's view.

1.4 This document summarises the key themes raised through the statutory consultation.

1.5 Also, alongside this decision document, we are publishing:

- a comprehensive issues log setting out stakeholder responses received to the Energy Networks Ring-fence Review Statutory Consultation and Ofgem's consideration of those responses; and
- tracked versions of the Electricity Transmission, Electricity Distribution and Gas Transporter licence modifications.

1.6 Appendix 1 contains a complete list of the licence conditions we have decided to modify.

## Context and related publications

- November 2025 Policy Consultation: Energy Networks Ring-fence Review consultation | Ofgem;
- July 2026 Policy Decision and consultation responses: Energy Networks Ring-fence Review consultation | Ofgem; and
- July 2026 Statutory Consultation: Energy Networks Ring-fence Review statutory consultation | Ofgem

## Decision-making stages

**Stage 1** Statutory consultation open: 1 July 2026

**Stage 2** Consultation closes 13 August (awaiting decision).

**Stage 3** Consultation outcome (decision): 20 October 2026

**Stage 4** Modifications will become effective 56 days after the decision to modify the licence is published.

# 2. Requirements for sufficiently independent directors (SIDs)

## Sufficiently independent directors – Completion of a checklist and template

### Statutory Consultation proposal

2.1 Further to our policy decision, in the statutory consultation, we proposed to require an annual confirmation of SIDs' details and relevant skills via a checklist and template.

### Stakeholder responses to statutory consultation

2.2 Companies did not generally support the proposed requirement to complete and submit a prescribed SID checklist and template in its current form. The principal concern was that the legal status, scope and modification process for the checklist or template had not been established, and final versions had not been provided alongside the consultation. Respondents considered that a mandatory checklist or template should not be capable of introducing substantive requirements beyond the SID criteria already specified in the licence.

2.3 Companies also questioned the proportionality and practical value of requiring submission by 31 July every year. Several respondents considered that relevant SID information was unlikely to change annually, that some criteria were not capable of meaningful yearly reassessment, and that equivalent information was already available through annual reports or ring-fence compliance reporting. Some respondents were prepared to accept an appropriately drafted evidencing requirement.

### Ofgem's view

2.4 We believe it is useful for the Authority to have annual confirmation of SIDs' skills and details even where the SID remains unchanged. In particular, we note the skills and experience of individuals may change over time. Annual confirmation helps ensure that the Authority has up-to-date information regarding whether the SID continues to meet the requirements of the licence and possesses the skills and experience necessary to perform the role effectively. As such, we consider an annual submission to be proportionate and to represent minimal administrative burden.

2.5 However, we agree that the requirement of a checklist or template within the licence drafting itself is overly prescriptive and unclear as to the form this would take. We therefore agree with licensees that broader wording within this condition would be more appropriate. Requiring a licensee to "confirm" that a SID meets requirements of the licence focuses on the substantive outcome to be achieved,

while allowing flexibility as to how that assessment is evidenced. and to "provide a statement" of skills the SID has that allow them to perform their role.

2.6 Where submissions from licensees under this broader wording are not sufficient, we may provide further guidance regarding the form and content of submissions through the Regulatory Instructions and Guidance framework. Any such guidance would be developed separately and subject to consultation.

### Decision

2.7 We have decided to amend the licence in accordance with the statutory consultation proposal of requiring an annual submission of a SID's details and skills for each sector.

2.8 We have decided to remove the reference to a "checklist" or "template" such that the licence is less prescriptive in relation to the submission. Instead, the licence will require the licensee to confirm that the SID meets the requirements of the condition and to provide details of the SID's relevant skills and experience.

2.9 The reason for this modification is to ensure the Authority captures the details and relevant skills of SIDs.

2.10 The effect is for the network companies to provide an annual submission of their SID's skills and details by 31 July.

## Sufficiently independent directors – Signatory on ring-fence submissions and notifications

### Statutory Consultation proposal

2.11 Further to our policy decision, in the statutory consultation we proposed mandatory SID co-signature (alongside another director) on specified submissions including for:

2.12 Availability of resource certificates and Statement of factors;

- Distribution certificates;
- Financial Resilience Report and notification of negative rating action/issuer credit rating withdrawal; and
- Notifications of disposals.

### Stakeholder responses to statutory consultation

2.13 Companies generally considered the proposals unnecessary and duplicative of existing governance arrangements. The respondents argued that:

- SID sign-off has not been shown to provide meaningful assurance beyond existing board governance and statutory directors' duties;

- Ofgem had not provided evidence that the current arrangements have failed to ensure appropriate SID engagement;
- SIDs will not be experts on the items Ofgem is requiring them to co-sign-off on thereby providing limited assurance;
- This proposal is inconsistent with the principle of collective board responsibility under the Companies Act 2006. They argued that all directors are already subject to the same statutory duties and that requiring SID co-signature risks implying a separate or enhanced responsibility for SIDs that is unnecessary; and
- The proposed licence modifications place obligations on the SID as opposed to the licensee, and that these obligations to sit within the relevant standard licence conditions as opposed to the SID standard licence conditions.

2.14 Some respondents requested a materiality threshold for a SID and other director sign-off particularly in relation to disposals.

## Ofgem's view

2.15 The purpose of this modification is not to create a separate category of director responsibility, but to provide additional independent oversight and challenge in relation to key ring-fence and financial resilience submissions.

2.16 While SIDs are subject to the same statutory duties as other directors, their role is distinct in that they are expected to provide objective scrutiny and challenge. Requiring SID co-signature helps to ensure that relevant submissions have been subject to independent review and that the SID has been appropriately engaged in the matters within those submissions.[2]

2.17 We do not consider the proposal to be inconsistent with the Companies Act 2006. The requirement simply recognises the different governance role performed by a SID.

2.18 We consider that the SIDs should be sufficiently informed and engaged in the relevant matters to provide independent challenge and appropriate oversight when signing these submissions.

2.19 We agree with the feedback that the obligation should be placed on the licensee rather than the SID personally, and that the sign-off requirements should sit within the relevant substantive licence conditions.

[2] The UK Corporate Governance Code assigns non-executive directors a distinct governance function of constructive challenge, strategic guidance, specialist advice and holding management to account.

### Decision

2.20 We have decided to modify the licence in accordance with the statutory consultation proposal of requiring a SID and another director to be signatories to certain financial resilience related submissions.

2.21 We have decided to make three amendments from our consultation position:

- Make the licence clear that the obligation of a SID signature (and another director) is placed on the licensee;
- Place the obligation of SID (and another director) signatures within the relevant standard licence condition and remove from the SID standard licence condition; and
- Removed the requirement for SID (and another director) signatures in relation to Published Rating Reports, as these reports are prepared independently by external credit rating agencies and we do not consider a director signature to provide meaningful additional oversight.

2.22 The reason for this modification is to provide further opportunity for independent and objective challenge, and assurance for certain financial resilience related submissions to the Authority.

2.23 The effect is that a SID, and another director, must sign certain financial resilience related submissions to the Authority.

## Sufficiently independent directors – Remuneration committee

### Statutory Consultation proposal

2.24 Further to our policy decision, in the statutory consultation, we proposed an obligation for a SID to attend the licensee remuneration committees. Where such committees occur at group level we proposed an obligation for a SID to make verbal representations.

### Stakeholder responses to statutory consultation

2.25 Companies generally opposed the proposed licence requirement for mandatory SID attendance at remuneration committees and prescribed representations on remuneration.

2.26 Respondents considered that Ofgem had not demonstrated that existing governance arrangements were inadequate or that the proposal would provide meaningful additional assurance.

2.27 They argued that the drafting was overly prescriptive, did not accommodate different corporate governance structures, could impose different requirements depending on whether remuneration was determined at licensee or group level,

and could create technical breaches or disproportionate consequences from procedural failures.

2.28 In particular, licensees did not support the requirement Ofgem proposed for SIDs to make verbal representations at a remuneration committee at the group level.

2.29 Some companies stated that SIDs are not experts in remuneration and therefore it is unclear what value there is behind a SID making verbal representations at a remuneration committee.

2.30 Some companies recognised that SID involvement can be valuable, and some already involve SIDs in remuneration governance. However, this did not amount to general support for mandating the proposed arrangements through the licence.

2.31 Companies also emphasised that any representation should reflect the SID's independent judgement rather than require the SID to advocate a predetermined management recommendation.

### Ofgem's view

2.32 We agree with companies that our proposed licence modification was overly prescriptive and could result in different obligations for a SID dependent on the corporate governance structure of the licensee. In particular, the proposal required representations at licensee level, or verbal representations where the remuneration committee operated at group level.

2.33 We consider it appropriate for SIDs to make representations on chair and executive remuneration. As independent directors, SIDs can provide additional challenge and scrutiny regarding remuneration outcomes and alignment with the long-term interests of the licensee. Executive remuneration can influence risk appetite, financial decision-making and management incentives and we therefore consider independent oversight of these arrangements to be relevant to the resilience and governance of regulated businesses.

2.34 Requiring SID involvement provides additional assurance that remuneration proposals have been subject to independent consideration. We do not consider this requirement to be unduly burdensome or disproportionate.

### Decision

2.35 We have decided to modify the licence to require a SID to make representations at either a licensee level or group level with respect to chair and executive remuneration.

2.36 This decision removes the proposed licence modifications that required verbal representations to be made at the group level. This therefore ensures the obligations placed on the SID are the same regardless of the corporate governance structure of the licensee.

2.37 The reason for this modification is to ensure a SID undertakes an active role in executive and chair remuneration discussions, which adds value due to the independent and objective role a SID fulfils within the licensee.

2.38 The effect of this modification is for a SID to make representations at either a licensee level or group level with respect to chair and executive remuneration.

# 3. RIIO-3 financial resilience measures to be extended to Electricity Distribution (ED) sector, ahead of ED3

## Statutory consultation proposal

3.1 Further to our policy decision, in our statutory consultation we proposed to modify the ED licence in line with the financial resilience measures introduced in RIIO-3 that took effect on 1 April 2026, including,

- requiring licensees to maintain more than one investment grade credit rating,
- introducing a distribution lock-up where Regulatory Gearing exceeds 75% RAV, and,
- strengthening financial resilience assessments, including forward-looking resource and stress-testing requirements.

3.2 We proposed to introduce these measures during ED2, as opposed to the beginning of ED3 in April 2028.

## Stakeholder responses to statutory consultation

3.3 Some companies believed these measures should not be introduced until the beginning of the ED3 price control.

## Ofgem's view

3.4 The ring-fence framework is an enduring feature of the licence and is not tied to any particular price control period. As such, it is intended to protect consumers and support the resilience of regulated businesses on an ongoing basis and we do not see a good reason why ED companies should remain outside of that framework for a further two years. We therefore do not agree that the modifications should be introduced at the beginning of the next ED price control

3.5 We also note that licence modifications are an established feature of the regulatory framework and these modifications do not alter the underlying price control framework, including allowed revenues or returns. Instead, they represent enhancements to the existing ring-fence arrangements.

### Decision

3.6 These measures have been in force for RIIO-3 licensees since 1 April 2026. We have decided, in-line with our proposal in our statutory consultation, to modify the ED licence now to maintain alignment across sectors and strengthen financial resilience protections.

3.7 The reason for this modification is to:

- align financial resilience measures across sectors;
- provide Ofgem with early visibility of potential financial resilience issues;
- strengthen protection of cash and financial resources held within the regulatory ring-fence; and
- provide Ofgem with a longer term view of a licensees' financial resources.

3.8 The effect of this modification is to require licensees to:

- Maintain more than one investment grade credit rating at all times and to notify Ofgem and provide specified reports when a negative rating action occurs or any credit ratings are withdrawn;
- restrict distributions if the licensee has, or is forecasting, Regulatory Gearing ratio of 75% or higher; and
- provide an extended financial resources certificate each year.

# 4. Availability of Resources

## Authority consent of proposed alterations to licensee capital and reserves

### Statutory consultation proposal

4.1 Further to our policy decision, in the statutory consultation, we proposed a new requirement for licensees to obtain Ofgem consent before converting capital or reserve categories that are non-distributable in nature where the effect of the alteration is to create or increase distributable reserves available for a dividend or other distribution.

4.2 The proposal was intended to strengthen the ring-fence by providing regulatory oversight of transactions that may increase distribution capacity.

### Stakeholder responses to statutory consultation

4.3 This proposal attracted the strongest stakeholder challenge. Licensees argued that reserve conversions are already governed by the Companies Act 2006, that financing and capital structure decisions should remain matters for management,

and that a consent regime would introduce regulatory uncertainty with potential implications for investability, cost of capital and Ofgem's financeability framework.

4.4 They also noted that Ofgem does not model reserves in the Price Control Financial Model nor does it consider them as part of its financeability assessments and therefore considering them as part of our ring-fencing arrangements would require a change to the basis on which Ofgem sets the price controls.

4.5 Several licensees proposed that a notification regime would be more proportionate than a consent requirement. Licensees also requested greater clarity regarding information requirements, decision criteria and timelines.

## Ofgem's view

4.6 The objective of this proposal is not to prevent legitimate corporate transactions or override management judgement on capital structure but to:

- provide Ofgem with early visibility of transactions that can materially increase a company's ability to make future distributions. While licensees are already subject to some distribution-related protections, many of those measures operate retrospectively or at the point a distribution is proposed. This proposal provides visibility at an earlier stage, before additional distribution capacity is created;
- provide the ability to review such transactions, engage with the licensee and request further information where wider financial resilience concerns exist; and,
- where appropriate, object to the transaction if it finds that the capital alteration would not be in the interests of consumers. We would expect the use of this power to be rare and will depend on the specific circumstances of the case, including any broader financial resilience concerns relevant to the regulated business and the interests of consumers.

4.7 We do not consider that the proposal is likely to have a material impact on investors' ability to earn an appropriate return on capital. The measure applies only to a narrow category of relatively infrequent transactions and does not affect allowed revenues, allowed returns or the operation of the notional company framework.

4.8 Whether a licensee chooses to undertake a reserve conversion depends on its individual corporate history, ownership structure and balance sheet position rather than the assumptions underpinning the notional company used for price control and financeability assessments. The proposal does not require Ofgem to determine whether a notional company has sufficient distributable reserves to fund a notional dividend. It concerns a specific category of actual-company transaction that may materially increase future distribution capacity and is

therefore distinct from the financeability assessment undertaken under the notional company framework.

4.9 While reserve conversions may be lawful and appropriate in many circumstances[3], Ofgem's statutory duties extend beyond the creditor protection objectives of company law and include protecting existing and future consumers and ensuring that licensees are able to finance and carry out their regulated activities. Compliance with company law does not therefore mean that a transaction is irrelevant from a ring-fencing or consumer protection perspective.

4.10 Having considered consultation responses, we remain satisfied that the underlying policy objective is justified but we recognise concerns regarding the proportionality of the original proposal. The revised approach retains Ofgem's ability to intervene where there are financial resilience and consumer protection concerns, whilst reducing regulatory burden and providing greater certainty for licensees.

## Decision

4.11 We have decided that a licensee must notify Ofgem before undertaking a reserve conversion transaction. Ofgem will then have one month of receiving all information reasonably required to review the proposal. In the absence of an objection, the transaction will be able to proceed.

4.12 We consider this strikes an appropriate balance between reducing regulatory burden and retaining an important safeguard where consumer protection or financial resilience concerns are present. Whether a proposed transaction raises concerns will depend on the particular facts and circumstances of the case, including any wider financial resilience considerations relevant to the regulated business and the interests of consumers.

4.13 A notification-only regime would provide transparency but would not provide the Authority with the ability to intervene in those circumstances where broader financial resilience concerns exist. In our view a minimum one-month review period provides sufficient time for regulatory scrutiny of a transaction while minimising unnecessary delay and uncertainty for licensees.

4.14 The reason for this modification is to introduce an important safeguard where consumer protection or financial resilience concerns are present.

4.15 The effect is for the network companies to provide a notification to Ofgem before making any alteration to a capital or reserve category, which is non-distributable by nature, where the effect of the alteration would be to create or increase distributable reserves available for a dividend payment or other distribution. The licensee must also provide such information, supporting documentation and

[3] See Appendix 2 for further information on the Companies Act and capital reductions

justification as the Authority may reasonably require. Ofgem may object to the proposed alteration within one month of receiving all information reasonably required to assess the proposal.

## Availability of resources – Reference to cash flow forecast

### Statutory consultation proposal

4.16 Further to our policy decision, in the statutory consultation, we proposed to amend the licence for statement of factors in relation to the 1F, 2F or 3F extended certificates to include a reference to a cash flow forecast.

### Stakeholder responses to statutory consultation

4.17 Some licensees stated they felt that the inclusion of a cash flow requirement was unnecessary as that same information is already embedded in the financial metrics supporting the extended certificates.

### Ofgem's view

4.18 The purpose of the modification is to improve visibility of forecast cash flows or liquidity over time. Cash flow forecasts provide information on expected cash inflows and outflows, working capital movements and liquidity pressures, whereas financial metrics provide valuable information regarding profitability, covenant metrics and balance sheet strength. We therefore consider the two sets of information to complement each other rather than duplicate.

### Decision

4.19 We have decided to modify the licence in line with our proposal at statutory consultation.

4.20 The reason for this modification is to improve Ofgem's visibility of forecast cash or liquidity over time.

4.21 The effect of this modification is to require licensees to include reference to cash flow forecasts in the statement accompanying the annual directors' certificate.

## Availability of resources – 1C and 2C compliance certificates and distribution certificate referencing all ring-fence conditions

### Statutory Consultation proposal

4.22 Further to our policy decision, in the statutory consultation, we proposed to amend the compliance and dividend and other distributions certificates to include the full suite of ring-fence and financial resilience conditions.

### Stakeholder responses to statutory consultation

4.23 The majority of licensees argued that the additional conditions are not directly related to financial resilience and therefore should not form part of the dividend certification process. Some respondents argued that the proposal could result in dividends being restricted before non-compliance had been formally established, including in circumstances involving governance or administrative issues with no material impact on financial resilience. Respondents also considered that Ofgem had not provided a sufficiently clear rationale for the change and argued that the proposal could increase uncertainty for investors, with implications for investability and the cost of capital.

### Ofgem's view

4.24 The purpose of the dividend and distributions certificate is to provide assurance that value is not being distributed from the regulated business at a time when the licensee is materially non-compliant with its ring-fence provisions. The additional conditions proposed for inclusion are:

- Sufficiently Independent Directors (43A, B22, A42);
- Independence of the Transportation/Distribution Business (42, A33);
- Disposal of assets and restrictions on charges (26, B3, A27); and
- The prohibition of cross-subsidies (4.9, B5, A35).

4.25 While these conditions do not contain explicit financial resilience requirements, they cover governance, independence, asset protection and the avoidance of cross-subsidies, all of which we consider key parts of the ring-fence framework that contribute to the resilience of the regulated business. We therefore consider it appropriate that a licensee, which is materially non-compliant with any of the above conditions, should take steps to address that non-compliance before distributing value from the regulated business.

4.26 We also note that the certificates require directors to confirm compliance "in all material respects", which provides an appropriate safeguard against purely technical or immaterial instances of non-compliance.

### Decision

4.27 We have decided to modify the licence in line with the statutory consultation proposal to require the compliance and distribution certificates to reference all ring-fence conditions.

4.28 The reason for this is to provide assurance that value is not being distributed from the regulated business at a time when the licensee is materially non-compliant with any ring-fence provisions.

4.29 The effect of this is that, when providing compliance and distribution certificates to Ofgem, directors must certify that the licensee has complied in all material respects with the conditions referred to in those certificates.

## Availability of resources – Intervention plan submission ad-hoc request and price control period

### Statutory consultation proposal

4.30 Further to our policy decision, in the statutory consultation we proposed for the intervention plan to be submitted to the Authority at the start of each price control period. We also proposed for the Authority to be able to request submission of the intervention plan on an ad-hoc basis.

### Stakeholder responses to statutory consultation

4.31 Some licensees argued that it is unnecessary for Ofgem to have the ability to request the intervention plan on an ad hoc basis.

4.32 Some ED licensees believed the proposed wording would put them in breach of the licence due to the timing of the modification.

### Ofgem's view

4.33 Although Ofgem may have powers to request information under other licence provisions, we consider it beneficial for the intervention plan condition itself to contain an explicit requirement for the plan to be provided on request, together with a clear submission timeframe to avoid any ambiguity. This ensures the Authority can obtain the licensee's latest contingency planning and assess the appropriateness of those plans.

4.34 We do not agree that the proposed wording would put ED licensees in breach of the licence due to the timing of the modification. Given the measure is being introduced part-way through the current price control period, we consider it appropriate to apply a transitional approach for ED2. Thereafter the ongoing requirement will align with other sectors and require plans to be submitted within three months of the start of each price control.

### Decision

4.35 We have decided to modify the licence condition in line with the proposal at statutory consultation.

4.36 For ED licensees, we expect a transitional approach to accommodate implementation part-way through the current price control period. Accordingly, we expect licensees to submit an intervention plan within three months of this licence modification taking effect. Thereafter, intervention plans must be submitted within three months of the start of each price control period, consistent with the approach adopted in other sectors.

# 5. Indebtedness

## Indebtedness – Housekeeping

### Statutory consultation proposal

5.1 Further to our policy decision, in the statutory consultation we proposed to modify the Indebtedness condition for ET and Gas licensees to clarify the structure of the condition and align with the clearer drafting of the ED sector.

### Stakeholder responses to statutory consultation

5.2 Some licensees did not agree with the proposed housekeeping re-structure of this condition.

### Ofgem's view

5.3 We believe the proposed restructure aids legibility and consistency across different sector's licences and does not change the meaning of the condition.

### Decision

5.4 We have decided to modify the licence condition in line with the proposal at statutory consultation.

5.5 The reason for this change is to improve consistency across different sectors.

5.6 The effect is the inclusion of subheadings throughout the condition and references to other linked licence conditions.

# 6. Independence of the network

## Independence of the network – Extend licence to the ET sector

### Statutory consultation proposal

6.1 Further to our policy decision, in the statutory consultation, we proposed to extend the independence of the network licence condition to the ET sector to align with other sectors.

### Stakeholder responses to statutory consultation

6.2 Respondents argued that the ET Special Licence Conditions already contain extensive provisions that ensure the independence of the transmission business and that introducing Standard Condition B2 would duplicate existing obligations and create unnecessary complexity.

### Ofgem's view

6.3 Having considered stakeholder feedback and reviewed the framework in more detail, we agree that the ET licence already contains licensee-specific provisions designed to protect the independence of the transmission business. Introducing Standard Condition B2 could create uncertainty without delivering any regulatory benefits.

### Decision

6.4 We have decided to not proceed with the proposed introduction of the Standard Condition B2 Independence of the transmission business in the Electricity Transmission licence given the current existing special licence conditions that contain very similar provisions. In the future, we may look to review the ET special licence conditions relating to independence together with the ET standard conditions licence with a view to create alignment of licences between different sectors.

## Independence of the network – Meter related services business definition

### Statutory consultation proposal

6.5 Further to our policy decision, in the statutory consultation, we proposed to modify the "Meter related services business" definition for Gas Transmission.

### Stakeholder responses to statutory consultation

6.6 Respondents were supportive of the proposed modification and suggested further drafting changes for clarity.

### Ofgem's view

6.7 We have considered stakeholder feedback, and we have made minor clarifying amendments to this proposal.

### Decision

6.8 We have decided to proceed with the modification of the "Meter related services business" definition with minor drafting amendments from the version consulted upon

6.9 The reason for this modification is to ensure that the licence definition remain up-to-date.

6.10 The effect of this modification is to update the definition in the GT Licence.

# 7. Disposal of relevant assets and restriction on charges

## Disposal of relevant assets and restriction on charges – Add reference to Financial Asset

### Statutory consultation proposal

7.1 Further to our policy decision, in the statutory consultation, we proposed to extend the restriction on granting security over receivables to a broader category of Financial Assets, and introduced a definition of Financial Asset[4].

### Stakeholder responses to statutory consultation

7.2 Respondents stated that the proposed definition of Financial Asset already includes receivables, and therefore a separate reference to receivables was unnecessary.

### Ofgem's view

7.3 We agree that the proposed definition of Financial Assets already incorporates receivables and have amended the drafting as such.

### Decision

7.4 We have decided to proceed with the modification. Following licensee feedback, we have removed the reference to "receivables" from the licence condition and have made a minor amendment to the definition of Financial Asset to correct an inadvertent omission from the consultation drafting,

[4] Per the definition under International Financial Reporting Standards (IFRS)

7.5 The reason for this modification is to strengthen protections over Financial Assets held by the regulated business.

7.6 The effect of this modification is to extend the restriction on granting security over receivables to the wider category of Financial Assets

# 8. Credit rating of the licensee

## Credit rating of the licensee – Multiple Credit Ratings

### Statutory consultation proposal

8.1 Further to our policy decision, in the statutory consultation, we proposed to apply the RIIO-3 requirement to maintain more than one investment grade issuer credit rating to ED licensees.

### Stakeholder responses to statutory consultation

8.2 Some licensees argued that requiring multiple ratings may discourage companies from obtaining a third or subsequent rating because a deterioration in any rating may trigger a distribution lock-up or other licence consequences, even where the licensee continues to hold two investment grade ratings.

### Ofgem's view

8.3 We acknowledge that a licensee holding more than the minimum number of ratings required may be exposed to a greater number of potential rating actions, however, each rating provides relevant information regarding a licensee's financial resilience and creditworthiness, and it would therefore be inappropriate to disregard a deteriorating rating simply because the licensee continues to hold two stronger ratings.

8.4 We have not seen evidence that this discourages licensees from obtaining additional ratings. Under RIIO-2, although only one rating was required, all licensees held more than one rating.

### Decision

8.5 We have decided to proceed with the modification as proposed at statutory consultation.

8.6 The reason for this modification is to strengthen the financial resilience provisions and therefore enhance consumer protection from a regulated entity's risk of defaulting on its debt.

8.7 The effect of this modification is to require licensees to maintain at least two investment grade issuer credit ratings and to ensure all issuer credit ratings held by the licensee are taken into account for the purpose of the licence conditions.

# 9. Restriction on activity and financial ring-fencing

## Restriction on activity – De minimis accounts reference and reconciliation

### Statutory consultation proposal

9.1 Further to our policy decision, in the statutory consultation, we proposed to align RIIO-3 sector licences with ED, to reference audited 'historical cost accounting statements'.

### Stakeholder responses to statutory consultation

9.2 Respondents agreed with the objective of the proposal but suggested that a reference to a licensee's audited statutory accounts would be clearer and more appropriate than historical cost accounting statements.

### Ofgem's view

9.3 We have considered stakeholder feedback and agree that a reference to audited statutory accounts provides a clearer and more consistent basis

### Decision

9.4 We have decided to proceed with this modification with an amendment to reflect stakeholder feedback.

9.5 The reason for this modification is to ensure that the licence references the most appropriate and readily identifiable audited financial information.

9.6 The effect of this modification is to require the relevant reconciliation to be based on the licensee's audited statutory accounts.

# 10. Definitions

## Ultimate Controller definition

### Statutory Consultation proposal

10.1 Further to our policy decision, in the statutory consultation we proposed amend the definition of "Ultimate Controller".

### Stakeholder responses to statutory consultation

10.2 A few respondents suggested minor typographical changes to the definition of "Ultimate Controller".

### Decision

10.3 We have decided to modify the licence in accordance with the statutory consultation proposal with some minor typographical amendments to resolve issues highlighted by feedback from the statutory consultation.

10.4 The reason for this is to ensures the definition is broad enough to capture individuals or different types of corporate bodies.

10.5 The effect of this is to improve clarity regarding the scope of persons or entities the definition relates to.

## 11. Impact Assessment

11.1 We have considered our duty under section 5A of the Utilities Act 2000 with regard to carrying out a statutory impact assessment. We do not consider that these licence modifications involve a major change to Ofgem's activities or that they are likely to have significant impacts on industry participants, the general public or the environment. We have therefore not carried out a full statutory impact assessment but have considered the impacts of the proposals in line with our impact assessment guidance.

11.2 We recognise that some of the modifications introduce additional governance, reporting and notification requirements. Throughout this review, we have sought to ensure that any incremental burden is proportionate and targeted. For example, a number of the measures are intended to provide earlier visibility of emerging financial resilience concerns, strengthen independent oversight of key submissions, or improve assurance that distributions are consistent with the objectives of the ring-fence.

11.3 In reaching our final decisions, we have carefully considered stakeholder feedback regarding administrative burden, investability and proportionality. This has resulted in a number of changes to the package consulted upon, including:

- replacing the proposed reserve conversion consent regime with a notification and review process;
- introducing greater flexibility in relation to SID involvement in remuneration discussions;
- removing the proposed signatory requirement for published rating reports; and
- deciding not to proceed with the proposed network independence condition for ET licensees.

11.4 We consider that many of the measures formalise, standardise or improve transparency around activities and governance processes that prudent network companies would already be expected to undertake, for instance the

requirement to certify compliance with all ring-fence conditions which is now explicit in the compliance and distribution certificate. In many cases, the modifications do not prevent companies from taking particular actions but instead provide greater transparency, clearer governance arrangements or earlier notification to the Authority.

11.5 Overall we consider that the decisions strike an appropriate balance between strengthening consumer protections and maintaining a stable and investable regulatory framework.

# Appendix 1. List of modified Licence Conditions

## Licence modifications

A1.1 We have decided to modify the following licence conditions:

- Standard Condition 43A *Requirement for sufficiently independent directors* of the Electricity Distribution licence;
- Standard Condition B22 *Requirement for sufficiently independent directors* of the Electricity Transmission licence;
- Standard Special Condition A42 *Requirement for sufficiently independent directors* of the Gas Transporter licence;
- Standard Condition 40 *Credit rating of the licensee* of the Electricity Distribution licence;
- Standard Condition B10 *Credit rating of the licensee* of the Electricity Transmission licence;
- Standard Special Condition A38 *Credit rating of the licensee* of the Gas Transporter licence;
  Standard Condition 41: *Restriction of Indebtedness and transfer of funds* of the Electricity Distribution licence;
- Standard Condition B9 *Indebtedness* of the Electricity Transmission licence;
- Standard Special Condition A39 *Indebtedness* of the Gas Transporter licence;
- Standard Condition 30 *Availability of resources* and Standard Condition 30A *Availability of resources* of the Electricity Distribution licence;
- Standard Condition B7 *Availability of resources* of the Electricity Transmission licence;
- Standard Special Condition A37 *Availability of resources* of the Gas Transporter licence;
- Standard Special Condition A33 Restriction on use of certain information and Independence of the Transportation business in the Gas Transporter licence;
- Standard Condition 26 *Disposal of relevant assets and restriction on charges* and Standard Condition 26A *Disposal of relevant assets and restriction on charges* of the Electricity Distribution licence;
- Standard Condition B3 *Disposal of relevant assets and restriction on charges* of the Electricity Transmission licence;
- Standard Special Condition A27 *Disposal of relevant assets and restriction on charges* of the Gas Transporter licence;
- Standard Condition B6 *Restriction on activity and financial ring-fencing* of the Electricity Transmission licence;
- Standard Special Condition A36 *Restriction on activity and financial ring-fencing* of the Gas Transporter licence;
- Standard Condition 1 *Definitions for the standard conditions* of the Electricity Distribution licence; Standard Condition A1 *Definitions and interpretation* of

the Electricity Transmission licence; and Standard Special Condition *A3 Definitions and interpretation* of the Gas Transporter licence *Definitions and interpretation* of the Gas Transporter licence.

# Appendix 2. Capital Reductions

A2.1 Under s641 of the Companies Act 2006, a company can reduce its share capital in one of two ways:

- By special resolution & a directors solvency statement (Ltd); or
- By special resolution confirmed by the court (PLC)

A2.2 The solvency statement route is available to limited companies and allows them to bypass the court approval requirement, meaning that the process can be done from board approval to filing at Companies House reasonably quickly and without any third-party approval or intervention.

A2.3 The court approval route is available to PLCs. This route takes longer and concludes with a court order allowing the capital reduction. The courts will focus on ensuring that creditor interests are not prejudiced and will allow the creditors to object to the transaction if they can demonstrate that they would be.

A2.4 Of the companies we regulate, the majority are PLCs however four are limited companies (Wales & West Utilities Limited, Cadent Gas Limited, Northern Gas Networks Limited and Electricity North West Limited) and would be able to use the solvency statement route to reduce and convert share capital, relatively easily and without Ofgem's awareness. We have seen evidence that WWU has undertaken such a transaction and subsequently issued a dividend.

## WWU example

A2.5 During FY24, WWU issued new shares to its immediate parent company WWU Holdings, creating approximately £1.1bn of share premium in the licensee.[5] WWU then undertook a series of capital reduction transactions which transferred the full £1.1bn share premium balance and c£30.7m of share capital into retained earnings/distributable reserves.[6]

A2.6 In FY25, WWU then used this distributable reserve to pay a dividend of £47m.[7]

A2.7 These transactions were undertaken through resolutions filed at Companies House and were lawful under the Companies Act 2006. No cash left the ring-fence at the point of conversion and this does not demonstrate that WWU did something wrong or that the transactions weakened resilience. However, the transactions materially increased the company's capacity to make future distributions by converting amounts that were previously non-distributable into distributable reserve, with no regulatory (or other) oversight.

[5] See disclosure note 18 "Called up share capital" on page 89 of WWU FY24 Accounts
[6] See disclosure note 19 "Share premium account" on page 89 of WWU FY24 Accounts
[7] See statement of Changes in equity on page 59 of WWU FY25 Accounts

## Send us your feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision. We would also like to get your answers to these questions:

- Do you have any comments about the quality of this document?
- Do you have any comments about its tone and content?
- Was it easy to read and understand? Or could it have been better written?
- Are its conclusions balanced?
- Did it make reasoned recommendations?
- Do you have any further comments?

Please send your feedback to stakeholders@ofgem.gov.uk.