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By email only to: mick.watson@ofgem.gov.uk

12 August 2026

Dear Mick

Statutory Consultation: Ring fencing

Thank you for the opportunity to respond to the above statutory consultation, dated 1 July 2026.

This submission represents a consolidated response on behalf of UK Power Networks' distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc.

We have set out in Appendix 1 our feedback on the main issues we have identified. A summary of those is set out below

1. Ofgem's decision to require that licensees obtain consent to amend existing capital and reserves requires a consequential change to Ofgem's assessment of the financeability and investability of companies at price control decisions – beyond our policy disagreement on this topic, Ofgem have misunderstood ENA feedback on this and our concerns remain unaddressed.
2. The licence drafting disincentivises networks from having a third credit rating – as drafted licensees would be penalised for having a third rating which we believe is counter to Ofgem's desired policy outcome.
3. Some of the licence drafting proposals potentially put networks in breach as soon as they are implemented – this can be cured through better drafting as already proposed by the ENA but not implemented by Ofgem.
4. The status of templates and guidance needs to be clarified and, if it is to be mandatory, provision to issue and update guidance must be included in the licence – this is to ensure appropriate governance arrangements are in place for any documents beyond the licence conditions.

5. The licence modifications associated with new roles for Sufficiently Independent Directors (SIDs) are inappropriately drafted, introduce obligations beyond Ofgem's stated policy and have adverse unintended consequences – these can be cured through better drafting as proposed in Appendix 2.
6. Ofgem has failed to explain its recent reversal of its proposed policy, resulting in the addition of a considerable number of further licence conditions into the list of licence conditions in scope of the dividend certificate. This introduces a disproportionate penalty that is potentially imposed before non-compliance with the licence is even established – the policy should revert to that previously communicated to licensees.
7. The quality of proposed licence modifications is inadequate for a statutory consultation – collaborative working with licensees is required to resolve the drafting issues prior to licence modification notices being issued.

In addition to these points set out in Appendix 2 is a track changed version of the electricity distribution licence conditions which shows the changes required to the proposed licence conditions.

Should you have any queries in relation to this response, please contact Colin Nicholl and Paul Measday in the first instance.

Yours sincerely



Basil Scarsella
Chief Executive Officer
UK Power Networks

Copy: Colin Nicholl, Head of Business Planning, UK Power Networks
Paul Measday, Regulatory Reporting and Compliance Manager, UK Power Networks

Appendix 1

1. Ofgem's decision to require that licensees obtain consent to amend existing capital and reserves requires a consequential change to Ofgem's assessment of the financeability and investability of companies at price control decisions

Ofgem's decision sets out that the Authority's consent would be required to amend existing capital and reserves under some circumstances. This proposal represents a very significant change to Ofgem's previous policy that actual company financing is for companies to manage. The policy restricts the rights of a licensee to make changes to its actual company structure.

We have previously identified that if this policy is to be implemented a change will also be required to Ofgem's approach to setting price controls to ensure that the notional dividend assumption can be paid (i.e. that accounting profits will be sufficient). This is to avoid internal inconsistency between elements of Ofgem's policy. This change may result in Ofgem needing to provide additional revenues to licensees to satisfy the financeability duty. No reference was made to this change in the recent ED3 SSMD.

In its response to the letter from ENA members on this topic, Ofgem seems to have misunderstood our point. Ofgem set out that "*We do not currently believe that a change to notional company dividend policy is required, as our modelling of notional company does not involve dividend payments from non-distributable reserves.*" This response misses that no part of Ofgem's current assessment process even considers accounting data. Ofgem therefore cannot know if sufficient distributable reserves are currently available and therefore cannot test whether its dividend yield threshold can be achieved. Ofgem must make a change to its assessment basis for ED3 and subsequent price controls to test its dividend yield assumption on a consistent basis with its ring-fence policy.

2. The licence drafting disincentivises networks from having a third credit rating

We have explained to Ofgem on several occasions that its proposed licence drafting has the effect of potentially penalising licensees, such as us, who opt to hold more than two issuer credit ratings.

Ofgem is clear that its policy is that licensees must "*maintain more than one investment grade rating at all times*".[1] However, Ofgem's proposed licence conditions for restriction of permitted transactions (triggered by circumstances in Part C of SLC41) would be triggered if a licensee's third credit rating was to be subject to Negative Rating Action. The approach taken in the licence drafting therefore places additional restrictions and obligations on those companies who opt to hold three Investment Grade Issuer Credit Ratings.

We cannot see any reference to the concerns that we have identified in Ofgem's policy decision. However, in the issues log shared with us, Ofgem's justification for not changing its proposed licence modification is set out as "*Ofgem wants to be notified of significant changes to all IG ratings, even when the licensee holds more than 2 IG ratings*".[2]

We agree that it may be sensible for Ofgem to be notified of such developments. Ofgem has already included the requirement for notification at paragraph 40.3. However, requiring notification is very different to locking up transactions with affiliates when a third issuer credit rating is subject to negative rating action. No such restriction would be placed on a licensee that was in possession of two investment grade issuer credit ratings.

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[1] Ofgem, Energy Networks Ring-fence Review - Policy decision, 1 July 2026 para 4.4
[2] Licence Drafting issues Log issued by Ofgem 6 July 2026, cell J81

Rating agencies only provide a rating if companies pay them to do so and they engage with company representatives prior to issuing updates to their reports. Faced with the prospect of a third rating ceasing to be investment grade or slipping to the lowest investment grade rating but on review for a possible downgrade etc, the logical course of action for a licensee may be to have the rating withdrawn. Withdrawing the rating would avoid a distribution lock up.

In effect, Ofgem's proposed approach to implementing its policy penalises those companies who may have the strongest resilience measures in place and so encourages them to potentially weaken resilience and the information available to Ofgem by removing the third rating. The licence drafting must be amended to avoid this.

We understand that transmission licensees made it clear that the licence drafting to support that policy decision should be improved and they agreed through the RIIO-T3 licence snagging process to progress improvements to that drafting through this ring-fence review. Ofgem also acknowledged our feedback in their ED3 Sector Specific Methodology Decision and stated that responses *"will be addressed separately in the Ringfence Review"*[3]. Unfortunately, the drafting has not been improved resulting in licence text that goes against the idea that additional credit ratings are positive for financial resilience and monitoring purposes by actively encouraging networks to remove a third rating if it deteriorates.

Ofgem should therefore amend the wording of the triggers of the restrictions in Part D of SLC41 so that they are only triggered when the requirement to hold more than one investment grade rating is at risk. We have provided drafting changes to achieve this in our detailed drafting mark-up.

3. **Some of the licence drafting proposals potentially put networks in breach as soon as they are implemented**

Ofgem is making changes to the licence that may automatically put networks in breach of their licence due to a failure to consider transitional issues.

Ofgem is introducing a new requirement into the Availability of Resources licence condition stating "*The Intervention Plan must be submitted to the Authority within 3 months of the start of each price control period"*[4]. As this condition is being introduced more than three months after the start of the price control period, licensees may automatically be in breach of this condition. A transitional arrangement is therefore required. This could be to provide a period of grace from the change coming into effect for licensees to submit their Intervention Plan, for Ofgem to provide a derogation to all licensees for the current price control, or for the drafting to be changed to refer to the end of the price control period. During the engagement sessions, ENA suggested alternative drafting that would achieve Ofgem's objectives using the latter of these three options. That suggested drafting is included in our mark-up of the licence conditions.

The consequences of not addressing these transition issues include all licensees potentially being unable to pay a dividend which will have consequences for the investability of the sector both directly from the inability to pay dividends, and through the deterioration in confidence in the regulatory regime that may result. If Ofgem does not make changes to the licence, it must provide consents or derogations to avoid these unnecessary consequences.

[3] ED3 Sector Specific Methodology Decision, page 79, paragraph 6.10
[4] Proposed modifications to the licence conditions – ED SLC 30.16, ET B7.16

4. **The status of templates and guidance needs to be clarified and, if it is to be mandatory, provision to issue and update guidance must be included in the licence**

Through the engagement sessions it has been clear that Ofgem intends to issue further documents relating to ring-fencing. These documents may take the form of templates, checklists or a guidance document. Based on content of the engagement sessions, we believe that, in most cases, Ofgem's intent is not to place additional obligations on licensees, but rather to provide a helpful steer of Ofgem's expectations, for example, what form and content of submissions the current Ofgem team considers would be an effective way of satisfying a licence obligation. Ofgem needs to be clear about which of three different types of 'guidance' it intends to issue in this regard.

Type One: Where Ofgem requires licensees to use a defined template or selection of words, such templates need to be defined in the licence. An example of this is the current Availability of Resources condition where the required text of submissions for the relevant certificates is defined in the licence. Any changes to this type of guidance would need to be made via the statutory licence modification process[5]

Type Two: If guidance is to be in a separate, associated document, the licence needs to name that document and set out the basis on which that document can be reviewed and updated (whether through direction or statutory modification).[2] When this process is followed, any guidance or templates become additional obligations with which compliance is mandatory. An example of this is the Price Control Financial Model (PCFM) or Regulatory Instructions and Guidance (RIGs).

Where Ofgem proposes guidance is to be mandatory, as is the case with the PCFM and RIGs, it must include appropriate provision to issue such guidance within the licence itself. Ofgem will need to:

- set out the scope and purpose of that guidance document in the relevant licence condition (e.g. SLC43A); and
- set out the process via which the guidance will be issued and modified in the licence. Depending on the permitted scope of that guidance, it may be appropriate for the guidance to be modified under section 11A of the Act.

Without such provision, guidance may not be issued as mandatory.

Type Three: If Ofgem does not intend to create additional obligations, the guidance provided should clearly state that compliance is not mandatory. It needs to be clear on the face of the document that following such guidance is optional, with licensees aware that such guidance simply represents a helpful steer from Ofgem.

<u>Ofgem's process for issuing the proposed SID checklist and template is inadequate</u>

Building on the above, Ofgem's proposed licence modification requires that licensees should submit a SID checklist and template. However, Ofgem has not provided any process for issuing or modifying these documents.

Ofgem has also not provided its proposed template and checklist alongside the statutory consultation. We provided a significant volume of comments on the draft SID checklist and template on 18 May 2026 but have not seen any further iteration of these documents. The earlier draft of these introduced requirements which are not set out on the face of the licence. Without sight of

[5] See, for example, SpC 9.4Re-opener Guidance and Application Requirements Document which clearly sets out the process by which the guidance will be issued and amended.

[2] See, for example, SpC 9.4 Re-opener Guidance and Application Requirements Document which clearly sets out the process by which the guidance will be issued and amended.

Ofgem's proposed template and checklist it is impossible for stakeholders or licensees to assess Ofgem's proposals.

The CMA was clear in its 2021 licence modification appeals that a licence condition may contain a mechanism for its later modification provided that the condition specifies the manner, and circumstances in or under which such a modification may be made. These criteria should be properly set out in the licence condition such that the licensee in question should be able to understand the potential impact on it of a future modification and be in a position meaningfully to appeal the condition.[6]

Ofgem would be acting ultra vires if it was to attempt to issue and expect licensees to comply with any guidance that effectively modifies the requirements of the licence.

In its working groups, Ofgem suggested that the template and checklist might be issued as an additional RIG. If Ofgem proposes that these documents will be issued as a new RIG, Ofgem needs to:

- incorporate the standard wording "*in accordance with the Regulatory Instructions & Guidance (RIGs) document issued under [standard condition 46 (Regulatory Instructions and Guidance)]*" in the relevant licence condition (i.e. SLC43A);
- restrict the scope of the template and checklist to the permitted scope of a RIG (which could not, for example, add additional responsibilities on SIDs or restrictions upon their appointment); and
- consult on the proposed form of the template and checklist in accordance with the process set out for new a RIG and take account of feedback provided in response to that feedback before issuing the RIG.

If Ofgem proposes that the checklist and template will be a separate, new guidance document, Ofgem will need to:

- set out the scope and purpose of that guidance document in the relevant licence condition (i.e. SLC43A);
- set out the process via which the guidance will be issued and modified in the licence. Depending on the permitted scope of that guidance, it may be appropriate for the guidance to be modified under section 11A of the Act; and
- consult on the proposed form of the template and checklist in accordance with the process set out in the licence.

5. The licence modifications associated with new roles for Sufficiently Independent Directors (SIDs) are inappropriately drafted, introduce obligations beyond Ofgem's stated policy and have adverse unintended consequences

We remain concerned that some of the new obligations required of SIDs are drafted in a manner that is unclear, fails to correctly implement Ofgem's stated policy or introduces unintended consequences including conflicts with other obligations in the licence.

<u>The proposed licence modification prescribes input from SIDs into remuneration discussions in a manner that exceeds the scope of Ofgem's stated policy, does not reflect established governance practice and inappropriately imposes different requirements depending on corporate structure</u>

Ofgem sets out that its policy is to "*require SID attendance at licensee Remuneration Committee, or equivalent, meetings where licensee executive remuneration is discussed and ratified*".[7] However, Ofgem has not appropriately reflected this policy in its proposed licence modifications.

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6 CMA, RIIO-2 Energy Licence Modification Appeals - Summary of final determination, 28 October 2021, para 42

7 Ofgem, Energy Networks Ring-fence Review - Policy decision, 1 July 2026 para 3.16

Firstly, the wording used assumes a particular corporate governance structure whereas, in practice, licensees adopt a range of governance models for determining remuneration. For example, where remuneration is discussed at licensee level, the drafting accepts that SIDs being involved in equivalent governance processes (i.e. other than remuneration committee) is acceptable, whereas, in contrast, where remuneration is considered at ownership group level it only refers to remuneration committee.

Secondly, the proposed obligations risk creating inconsistency by imposing requirements depending on corporate structure rather than focussing on the desired governance outcome. For example, if the licensee has its own remuneration committee, the requirement is for a SID to be in attendance, whereas if the committee is held at ownership group level the requirement is that a SID must make verbal representations, i.e. a greater obligation is applied in respect of licensees where remuneration is considered at ownership group level than at licensee level.

Thirdly, the expectation of verbal representations where a group committee exists is unduly prescriptive and beyond the scope of Ofgem's stated policy. In many cases, written input is the more appropriate and effective mechanism, and a requirement to make representations in all circumstances risks becoming a formality rather than adding substantive value. Likewise, the proposal that a SID must be "in attendance" at a meeting could be read as meaning that a SID cannot dial in to a meeting remotely. The virtual attendance of a meeting can often be an efficient and effective means of securing input to the discussions.

We have previously provided suggested drafting that would address all the above concerns:

> *At least one sufficiently independent director must have the opportunity to make representations each year in respect of the licensee's executive directors' remuneration to those who determine such remuneration.*

We would welcome further engagement on why that drafting approach has not been taken forward. Neither Ofgem's response to the ENA letter of 29 June nor Ofgem's latest drafting issues log explain why Ofgem has opted to not use our proposed wording.

<u>The proposed licence modification in respect of the SID role in notification of asset disposals to another company or entity operating within the same group of companies creates conflict with pre-existing licence conditions</u>

Ofgem sets out that its policy is that *"a SID and at least one other director would be signatories of the following notifications to the Authority: […] Proposed asset disposals to another company or entity operating within the same group of companies as the licensee."* [8]

However, Ofgem's proposed licence modifications create a number of interactions with pre-existing licence conditions. In particular, it is unclear in the proposed modification how the new requirement for notification is expected to interact with the general consent to dispose of or relinquish control of an asset as set out in the existing disposals conditions. Our understanding from working groups is that Ofgem does not intend for the change in ring-fence policy to amend the circumstances under which notification would be required (i.e. the change is simply to mandate the approval process for such notifications) and that this issue is an unintended consequence of the drafting.

This would be logical as the general consent provisions set out circumstances where Ofgem has previously determined that it is not in customers' interests for notification processes to be required. These include scenarios such as disposal of redundant assets, disposal where electrical equipment can remain in use under an easement or wayleave, or low value disposals/ relinquishments.

[8] Ofgem, Energy Networks Ring-fence Review - Policy decision, 1 July 2026 para 3.8

Without correction, this may materially increase the volume of notifications that licensees must make and that Ofgem will receive and need to consider. This will increase costs for no customer benefit.

Firstly, it is not clear in SLC43A that the requirement for a SID signature for disposal to an affiliate only applies if the disposal/relinquishment in question would require notification to the Authority – no cross-reference to the relevant disposals condition that sets out the notification requirement is provided. The wording in SLC43A could be interpreted as requiring SID signatory and notification to the Authority even in circumstances where no notification is required because general consent has been provided (e.g. if one DNO was disposing of a redundant asset to an affiliate DNO who is able to make use of it on its network). It would not be in customers' interests to introduce a new senior approval process and potentially delay transactions in such circumstances.

Secondly, the proposed licence modifications are unclear as to which types of assets fall within scope. The proposed modification in SLC43A refers to "asset disposals" and the proposed modification to SLC26 refers to "distribution asset". Neither of the terms are proposed to be defined. The current notification requirements are limited to the disposal or relinquishment of Relevant Assets when general consent does not apply. We do not believe that it is Ofgem's intent to extend the scope of the required notifications to other asset classes.

Thirdly, the wording of paragraph 26.10 confuses this further by adding the new paragraph at the end of the condition, rather than at a more logical point in the document, and could be read as introducing a new obligation rather than clarifying the approval process that licensees must follow if the notifiable transaction happens to be with an affiliate.

The drafting must be amended to be clear that the new policy makes no change to the scope of required notifications or the circumstances where the general consent provisions in the current licence apply. The above issues would be better addressed by incorporating the requirements on SIDs directly at the point at which Ofgem establishes the notification requirement, thereby making it clear how the requirements on SIDs interact with the wider requirements of the relevant condition. We have set out proposed wording in our drafting mark-up.

<u>The proposed licence modifications in respect of SID role in the submission of a Financial Resilience Report, Published Rating Reports and withdrawal of a credit rating confers obligations beyond Ofgem's stated policy and is ambiguously drafted</u>

Ofgem sets out that its policy is to "*a SID and at least one other director to sign-off submissions and notifications*".[9] However, Ofgem has not appropriately reflected this policy in its proposed licence modifications.

Ofgem's policy decision is not clearly documented; however, we understand from Ofgem's working group meetings that Ofgem's policy intent is that the "submissions and notifications" referred to here are: (a) submission of any Financial Resilience Report; (b) notification and submission of associated Published Rating Report in the event of Negative Rating Action; and (c) notification and submission of any associated Published Rating Report in the event of a credit rating being withdrawn.

Firstly, the proposed licence modification seems (at paragraph 43A.9(b)) to create a requirement that a Financial Resilience Report submission must be subject to a Board resolution. This is not a requirement of Ofgem's proposed policy. Furthermore, it may not be practicable for the Financial Resilience Report to be developed and the final report to be subject to full Board review within the constraints of the 60 days that Ofgem allows for this process. While the circumstances that led to a Financial Resilience Report being required would naturally be subject to Board discussion, requiring

[9] Ofgem, Energy Networks Ring-fence Review - Policy decision, 1 July 2026 para 3.16

the final document to be subject to a Board resolution is impracticable within the time constraints that Ofgem proposes. Ofgem must draft its proposed licence modification in line with its policy intent and remove the requirement for a Board resolution.

Secondly, the required scope of relevant "submissions and notifications" is unclearly drafted within SLC43A and appears to suggest a different trigger for notifications to that set out in SLC40. For example, SLC40 requires submission of Published Rating Reports when Negative Rating Action occurs, whereas paragraph 43A.10 requires SID approval of notifications in the circumstances where "*any change in credit rating and / or outlook which would trigger a negative rating action, to a rating of BBB- or one notch above the minimum covenant requirement and is on negative watch*" and refers to similar, but undefined terms. If it is Ofgem's intention that director signature is only required if the Published Rating Report signals the potential for a downgrade to BBB-, this should be clearly set out in SLC40.

The drafting must be amended to ensure internal consistency of wording between the requirements for submission and the requirements for SID approval of that submission. The above issues would be better addressed by incorporating the requirements on SIDs directly at the point at which Ofgem establishes the notification requirement in SLC40, thereby making it clear how the requirements on SIDs interact with the wider requirements of the relevant condition. We have set out proposed wording in our drafting mark-up that achieves this.

6. **Ofgem has failed to explain its recent reversal of its proposed policy to add a considerable number of further licence conditions into the list of licence conditions included in the scope of the dividend certificate. This introduces a disproportionate penalty that is potentially imposed before non-compliance with the licence is even established**

In its policy decision and associated licence drafting, Ofgem has added a considerable number of further licence conditions into the list of licence conditions included in the scope of the dividend certificate. This change is contrary to the position that Ofgem shared in previous working groups (and acknowledged in cell H39 of its policy feedback shared on 27 April) where it agreed that it would be inappropriate for a dividend lock-up to be triggered in the event of a potential breach of those additional licence conditions. Ofgem has provided no explanation of its logic for this change, either in the policy decision or in the issues log it has provided to us. To make such a change to potentially block distributions without any justification of the reversal of Ofgem's position fails to recognise the significance of this for investors. This policy introduces a disproportionate penalty (prevention of dividends) that is potentially imposed before non-compliance with the licence is even established.

We continue to maintain that the inclusion of these extra licence conditions in the scope of the dividend certificate is inappropriate. There is a very real risk of increased costs to consumers via increasing the cost of capital if investors think they are less likely to receive a dividend. There is also a risk that investors may reasonably view these additional risks as a good reason to extract as many dividends as they can and when they can, rather than assuming they can get the dividends later. Even if non-compliance was proved, the licence conditions in question do not indicate financial resilience concerns that are relevant to considering whether a dividend could be made; for example, failure to notify the Authority of the relinquishment of control of an asset that is just above the ~£32k limit is unlikely to create circumstances where a dividend should be prevented.

7. The quality of proposed licence modifications is inadequate for a statutory consultation

We have provided Ofgem with considerable feedback on issues with the quality of its earlier licence drafting and are disappointed that a volume of issues remain in the statutory consultation. We have explained above the most material issues with the implementation of Ofgem's stated policy in this response and also set out in Appendix 2 a mark-up of the draft licence modifications.

We must be given a further opportunity to review Ofgem's corrected licence modifications ahead of the modification notices being issued and this should include a further licence drafting meeting being held once revised drafts have been shared to allow solutions to any remaining drafting issues to be agreed. Ofgem lawyers should be present at that meeting, those lawyers having conducted a peer review of all logs and documents ahead of the meeting.

Appendix 2

Please see separate file.