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To: "michael.fews@ofgem.gov.uk" <michael.fews@ofgem.gov.uk>
Date: 11/22/02 4:48pm
Subject: REVIEW OF THE LICENSING APPLICATION REGULATIONS

Dear Michael

Review of the Licensing Application Regulations

I am pleased to provide the comments of Aquila Networks ("Aquila"), holder of an Electricity Distribution Licence.

We agree that the energy market has evolved sufficiently to enable a review of the licensing application process. However, it is essential that the right balance is struck between minimising barriers to entry and appropriate regulatory safeguards in order to best serve the interests of customers and other market participants.

In view of this, the key points of our position may be summarised as follows:

- * The implementation of Ofgem's proposal not to conduct ex ante financial checks, must be aligned with the implementation of a revised framework for securing credit cover;
- * The scope of 'route to market' entry testing should be broadened, to assess capability in functions such as customer billing;
- * The current level of information required in respect of the ability to discharge duties and obligations, should be retained.

I will expand on these points and deal with some of the other issues raised in the paper, below.

Notices of Application

Ofgem's proposals for the publication of 'notices of applications' are sensible. In particular, that notices be published on its website and the use of its email distribution list to notify interested parties.

Schedule 1: 'General Particulars' and 'Details of Application'

We agree with the proposals to retain the current information requirements with regards to 'General Particulars' and 'Details of Application'. Ofgem should also continue to check for disqualification from being a director. We support the proposals to check for undischarged bankrupts and that applicants submit a declaration about unspent criminal convictions.

It is reasonable to expect a level of integrity at the point of granting a licence.

Schedule 2

'Financial Information', 'Proposed Business'

We are not convinced by the strength of the argument that a 'moral hazard' is created by Ofgem requesting business plan information as part of the licensing process. We believe that commercial incentives will ensure that any financial assessment conducted by financial institutions and parent companies is done so independently. Ofgem does acknowledge that such tests will be far more rigorous than any it is capable of conducting.

However, we do accept that ex ante financial checks do not guarantee ongoing financial stability. This reinforces the need for alternative safeguards to ensure that there is no adverse impact on consumers and market participants. In particular, we agree with Ofgem that there is some room to improve arrangements for securing credit cover and we continue to work towards the implementation of a robust framework for credit cover and the recovery of bad debt.

Ofgem's proposal not to check the reasonableness of an applicant's business plan would nevertheless mean the removal of an additional layer of scrutiny and initial comfort, such that we would expect the revised applications process to be aligned with the implementation of revised credit cover arrangements.

We agree with Ofgem that it should check the applicant's details with the DTI Insolvency Service, prior to granting a licence.

'Expertise'

Whilst we agree that 'route to market' entry testing provides better protection than the ex ante provision of information about an applicant's expertise, we believe there to be limitations with the current arrangements.

MRASCo, Elexon and SESL testing is concerned with the capability to operate within the market and therefore focuses on 'business to business' processes. In the case of supply licensees, we believe that there is considerable merit in broadening the scope of assessment to include the applicant's 'customer facing' functions of billing and revenue collection. These are critical to the financial health of the business and are believed to have been a major contributory factor in the failure of Independent Energy. Testing of these functions could help to prevent similar problems from arising in the future. This would reduce potential risk and disruption and help to maintain customers' confidence in the role of suppliers and the competitive market.

Schedule 3: 'Further Information and Documents'

Whilst we accept that ex ante financial checks have limitations, we believe it entirely appropriate that Ofgem should seek prior reassurance that an applicant has thought about the way in which it will discharge its statutory duties and obligations. We believe that the requirement for this level of protection goes beyond domestic customers.

I can provide a couple of examples relevant to Aquila, as an electricity distributor. It is important that an applicant complies with our Distribution Code from the outset, as non-compliance could impact on the network (and ultimately customers). It has also been apparent for some time that there are weak incentives on suppliers to discharge their obligation to detect and prevent the theft or abstraction of electricity. This again could have a negative impact on distributors and customers, in terms of increased

electricity losses.

By being required to demonstrate their understanding of such obligations and their intended compliance mechanisms, Ofgem would give applicants a strong signal that compliance is expected from the outset.

Health and Safety

We appreciate that Ofgem wishes to avoid duplicating the duties of the DTI and we note that "Ofgem will notify the DTI Engineering Inspectorate where it grants a distribution licence" (6.22). It may be helpful that the Inspectorate also be specifically notified of each application via Ofgem's email distribution list, in addition to copying the Secretary of State.

We assume that Ofgem is liaising with the DTI regarding compliance with safety matters, in the context of a licence application. The Authority, in carrying out its functions, is of course required to take into account any advice given by the Secretary of State about any electricity safety issue.

I hope you find our comments helpful and should you wish to discuss any particular point, please contact Paul Finch of my office.

Yours sincerely,

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