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Dear Nicola

SECTION 8A OF THE ELECTRICITY ACT 1989: MODIFICATION OF THE STANDARD CONDITIONS OF DISTRIBUTION LICENCES

I am writing to you about Ofgem's proposals to modify the standard conditions of licences for new electricity distributors. You will be aware that London Electricity Group has extensive interests in both licensed and licence-exempt distribution activities. We expressed our strong concern about your proposals when Ofgem first consulted on them nearly a year ago.

As you know, the standard licence conditions which Ofgem proposes to modify were determined by the Secretary of State, using powers under Schedule 7 of the Utilities Act 2000, in a licensing scheme which came into force in October 2001. Ofgem has power under the Electricity Act 1989 to modify those conditions on the grant of a distribution licence. The procedure for this is set out in section 8A of the Act and contains provision for the Secretary of State to veto any modifications.

The licence modification now proposed involves (i) the transposition, into Section B of the licence, of amended versions of five conditions now located in Section C and (ii) the introduction into Section B of a wholly new condition which regulates the licensee's charging arrangements. All of these new standard conditions would be incorporated, in a blanket fashion, into any future licence granted by Ofgem under section 6(1)(c) of the Act.

There are major objections to certain aspects of these proposals. For example, at least one of the modifications – the new charging restriction – will be capable of being modified further, at any time, under the statutory process for collective licence modifications. We feel that this is particularly undesirable in relation to a price control condition. As a principle of public policy, the most fundamental restriction in someone's electricity licence, namely the condition that regulates the revenue that he is able to earn from his licensed activities, should not be

put at risk of being modified (to his detriment) by the majority view of other licensees (some or all of whom may be his competitors).

But a more fundamental concern is the questionable legality of the proposals in their present form. If implemented, they would fetter Ofgem's discretion in the treatment of licence applications, and would also ensure that persons making such applications are denied the protection of any of the elements of personal consideration and specific due process which are a clear requirement of section 8A. These outcomes cannot be right and would make the arrangements unlawful on both counts.

Ofgem fails to recognise that the provisions of section 8A of the Act are not framed to operate on a pre-emptive basis. Section 8A contains a mandatory process which applies whenever Ofgem wishes to modify any standard condition 'when granting a licence' (see paragraph 59 of the DTI's Explanatory Notes to the Utilities Act), and which cannot be circumvented. The effect of these provisions is that, in considering applications under section 6A for a distribution licence, Ofgem must**:**

1. Consider if any modifications of the standard distribution licence conditions are appropriate in the light of all the actual circumstances of the would-be new distributor's application;

2. Ensure that any modifications proposed as a result of **1** are those (and only those) that are 'requisite to meet the circumstances of the particular case' (see section 8A(2));

3. Consult before granting each such licence on any modifications that appear to Ofgem to satisfy the test of **2** and consider the comments received (see sections 8A(3)–(4)); and

4. Reasonably form the opinion in the light of **1** to **3** as a whole that the new licensee would not be 'unduly disadvantaged' in competing with other holders of distribution licences (which would include the ex-PES licensees as well as other new or prospective licensees) (section 8A(6)).

The whole scheme of these statutory provisions is based on the recognition that any general licensing policy adopted by Ofgem may not hold good in the case of each individual licence applicant. The consultation process, and in particular the proper application of the tests mentioned at **2** and **4** above, might necessarily produce quite different results in different cases. A range of such outcomes would, of course, be consistent with good administrative practice anyway, as well as being directly contemplated by section 8A.

Every one of the requirements of section 8A would be nullified by Ofgem's policy intention not to grant new distribution licences unless they contain certain standard conditions that have been modified by Ofgem on a predetermined basis, regardless of the merits of the specific case. This is why we believe that the policy represents an unlawful fettering of discretion. Moreover, in the narrative published with the statutory notice, there is not even a pretence that what is envisaged is a general licensing policy which Ofgem would be minded to apply subject to individual

considerations. On the contrary, the clear intention is to modify the standard licence conditions now, in advance of all future applications for new distribution licences, and then to grant only licences which contain those modified conditions.

The effect of this is that section 8A would not be brought into play at all in relation to future licence applications, including, of course, applications from companies not yet even formed, of which Ofgem can have no knowledge. So, in addition to the unlawful fettering of discretion in relation to the treatment of licence applications, Ofgem's present approach would have the further unlawful effect of denying applicants their right to the benefits and protections of due process which are a clear requirement of the provisions of section 8A.

On this basis, once the proposed licence modifications are made, no future applicant for a distribution licence would have the opportunity to exercise either his right as a consultee to make representations about the modifications, or his ultimate right as an objector to ask the Secretary of State to veto them. This would be a perverse result which is neither provided for, nor permitted, by the Act.

This analysis points clearly to the conclusion that, regardless of the pros and cons of your proposals on any other grounds, the intended modifications are challengeable in law. Given your policy objectives in relation to new distributors, we believe that the appropriate and indeed the only permissible course is to publish a statement which sets out in general terms the modifications of the standard conditions which Ofgem will be minded to make when granting new licences, subject always to all the specific circumstances of each case and the requirements of the Act.

We have copied this letter to Edward Blades and Deborah Collins at the DTI. We are happy to meet with you and them to discuss these issues if you think that would be helpful. As you know, the period for statutory consultation on the proposals expires on 16 May.

Yours sincerely

Roger Barnard

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