National Grid

Transco

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Gary Keane
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Dear Mr Keane

CONSULTATION ON THE MODIFICATION OF STANDARD LICENCE CONDITIONS FOR A NEW ELECTRICITY DISTRIBUTION LICENCE HOLDER

The National Grid Company welcomes the opportunity to comment on the above consultation.

We agree that in modifying the Licence of ENL (or any other DNO) it should not be unduly advantaged or disadvantaged in competing with other holders of electricity distribution licences.

National Grid has concerns regarding the arrangements being proposed in respect of the credit rating of ENL. The Connection and Use of System Code (CUSC) provides the contractual framework for parties connected to or using NGC's Transmission System. Where NGC provides connection assets for a customer then CUSC currently provides that companies with credit ratings of A-\A3 are not required to provide credit cover for Connection Charges or Termination Amounts relating to these connection assets. In addition Distribution licensees are not required to provide credit cover if they maintain the credit rating required by their licence, normally BBB-\Baa3. We are concerned that the proposed licence modification will relax the credit rating requirement for DNOs if alternative forms of credit such as Parent Company Guarantees are offered. We believe that this will reduce the surety of NGC and other network operators of recovering their allowed revenue.

Parent Company Guarantees (PCGs) have a number of flaws that have been amply demonstrated by the failures in the electricity industry recently. In reality PCGs provide little certainty that there is an ability to recover monies due - particularly where the company is registered outside the UK. Where payment is not made, the guarantee would need to be enforced through the courts and if the parent company has no assets in the UK, this process may be costly, time consuming and with uncertain outcome. An additional point is that the PCGs are intended to secure a subsidiary, not enforce the ring-fence around it. Therefore if a parent fails, the PCG will fail, and the ring fence will be broken.

The proposed modified SLC 46 would appear to permit Ofgem to allow arrangements that could, in reality, provide no comfort to creditors that they would have a realistic ability to recover monies due. SLC 46 should make clear that any alternative financial arrangements must be at least as effective in providing creditors with an ability to recover monies due as if the Licensee (ENL) were to have had an investment grade issuer credit rating.

National Grid faces exposures from a failing DNO in a number of ways, for example until a replacement DNO is identified; unpaid Connection Charges could arise. There is no concept of DNO of last resort and, hence, no guarantee that anybody else would wish to take over the distribution network (especially if they can't increase charges). If a replacement DNO were to be found they are unlikely to accept liabilities incurred prior to it taking over from the failed DNO.

The risk that a DNO could default on payments is real and financial ring fencing is not a guarantee that it will not happen (e.g. obligations to ensure the licensee is properly financed didn't work for Railtrack). Despite the requirement on DNOs to be ring-fenced the rating agencies don't give them AAA ratings – so clearly the market considers that DNOs can default.

Independent distribution networks present an even greater risk than the ex-Regional Electricity Company DNOs since it is likely that their business is based on a far smaller number of customers. Failure of a major customer could then result in failure of the DNO - particularly if the DNO was originally developed to serve a small number of major customers. The price cap proposed by Ofgem would also appear to prevent the DNO from increasing charges to recover lost revenue. National Grid believes that DNOs should be able to pass through the costs of providing security and in relation to small (non-ex REC) DNOs these costs could be higher than for the existing Licensed electricity distribution companies. The price cap suggested by Ofgem would seem to imply that such smaller DNOs are automatically disadvantaged simply because of their size – quite the reverse of Ofgem's stated objective of not unduly discriminating. Where higher costs justify a higher charge then the DNO should be permitted to pass these higher costs on.

If you would like to discuss further, please get in touch either with me or with Andy Balkwill (01926 655988).

Yours sincerely

Tim Tutton
UK Director of Regulation, National Grid Transco