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Dear Colleague,

### **Application of Section C licence conditions for Independent Distribution Network Operators**

#### *Background*

Ofgem has recently granted distribution licences to Laing Energy Limited, Independent Power Networks Limited and GUC. These are the first distribution licences to be granted to companies other than those treated as granted to the distribution businesses that were formerly part of the public electricity suppliers (the ex-PES DNOs).

Independent Distribution Network Operators (IDNOs) will own and operate electricity distribution networks which will predominately be network extensions connected to the existing distribution network, e.g. to serve new housing developments on both greenfield and brownfield sites.

The licences held by IDNOs differ from those of the ex-PES DNOs in that they do not have section C of the distribution licence switched on. Section C sets out requirements that an ex-PES DNO is obliged to comply with in its distribution services area (DSA). IDNOs do not have section C obligations and therefore have no DSAs.

Some of the provisions in section C are more wide ranging and could be applied to distributors operating on a GB basis. These include those provisions relating to the financial ring fence, meter point administration, compulsory acquisition of land, and supplier of last resort payment claims. It is for consideration whether these provisions should apply to all licensees on a GB basis.

## *Section C standard licence conditions (SLCs)*

### SLCs 43 to 47 - Financial ring fencing

The use of financial ring fencing provisions was considered as part of the licence application for IDNOs. These provisions are an important safeguard to consumers and Ofgem has concluded that they should apply to all licensed distributors. In light of this, the licences granted to the IDNOs have been modified using the provisions of section 8A of the Electricity Act (the Act) to introduce amended standard conditions BA2 to BA6 which broadly replicate the provisions of SLCs 43 - 47.

### SLC 37 – Meter point administration service

The Meter Point Administration Service (MPAS) provisions of the licence have been transferred from section C of the licence to amended SLCs 14 –14C in section B of the licence to ensure that all licensed distributors are required to be party to the Master Registration Agreement, establish a MPAS and provide a charging statement for such services. This amendment took effect before any of the three IDNO licences were granted.

These are the main elements from section C that presently apply to all distributors including IDNOs. Ofgem has reviewed the section C licence conditions and identified three further conditions that it considers could be applied on a GB basis, and therefore included within the IDNO licences. These are:

- SLC 34 – Compulsory Acquisition of Land etc.
- SLC 35 – Other Powers etc.
- SLC 48 – Last Resort Supply: Payment Claims

For all the ex-PES DNOs these powers and obligations currently apply in relation to their defined DSA.

### SLC 34 – Compulsory Acquisition of Land etc, SLC 35 – Other Powers etc

Both SLC 34 and SLC 35 activate statutory powers contained within the Act. SLC 34 gives effect to Schedule 3 of the Act which provides powers for compulsory acquisition of land while SLC 35 gives effect to schedule 4 of the Act which provides powers to dig up the road. These powers, if provided for in the licence, allow a distributor to compulsorily purchase land and dig up roads if either of these proves necessary in relation to connection work. However, these powers can only be exercised if the provisions of the relevant licence conditions have been switched on.

The need for IDNOs or new entrants to have the street works and compulsory land acquisition powers was considered in the final proposals for the Utilities Act. At that time Ofgem did not believe that a sufficient case had been made to support the automatic inclusion of these conditions within the IDNO's distribution licence. Moreover, these issues were not considered further when Ofgem awarded the three IDNO licences in 2004. Therefore, under the provisions of the licence, the IDNOs do not have the power to undertake such street works or land acquisition. It is also worth noting that the ex-PES DNOs' powers under these licence conditions are limited to activities within their DSA.

With the IDNOs undertaking new developments, predominantly extensions to the distribution network such as housing estates, the need for access to public highways may be considered to be limited and similarly, the need for compulsory acquisition of land. However, some of the IDNOs are undertaking larger scale brown field developments where connections are required back to the existing distribution network which will cut across public highways. Some of these developments may, in some cases, need powers for compulsory purchase of land to provide the connection.

The IDNOs and ex-PES DNOs are exempted from their obligations to connect if the powers of schedules 3 and 4 are not active. Therefore, neither IDNOs nor ex-PES distributors operating outside the DSA would be in breach of their statutory duties for failing to connect where they could not secure access to land or the highway. Nevertheless, Ofgem considers that the absence of these powers could constitute a significant barrier to the development of competition in the provision of distribution assets, as it may preclude full entry of some companies within the market. In light of this, Ofgem is now consulting on whether these provisions should apply to all licensed distributors on a GB basis.

#### SLC 48 – Last Resort Supply: Payment Claims

SLC 48 details the circumstances in which a licensee must increase its use of system charges in order to compensate a supplier who has become a supplier of last resort. In the absence of this condition, the IDNO would not be obliged to pay the supplier of last resort their losses incurred and claimed. Although this is unlikely to be a material condition in the near term as IDNOs will initially be small, with time it will be necessary to include the same obligation on IDNOs.

#### *Licence amendment and SLC 2 powers*

In order to give effect to these provisions for the IDNOs and for ex-PES DNOs operating out of area Ofgem considers that there are three mechanisms available:

- 1) Use powers in SLC 2 to switch on part of Section C, i.e. SLCs 34, 35, and 48, for the IDNOs. A similar approach could be used for ex-PES DNOs operating out of area by varying their DSA direction to specifically include certain conditions on a GB basis.
- 2) Undertake a collective licence modification (CLM) for all distribution licensees to modify SLCs 34, 35 and 48, and to introduce new conditions in section B of the licence. This would then apply to all licensees independent of any DSA.
- 3) Undertake individual licence modifications for each of the IDNOs to introduce a new special condition or an amended standard condition and also undertake individual licence modifications for ex-PES DNOs operating out of area as necessary.

Ofgem proposes that option (2) is used to modify the licences as this enables the issue to be resolved at once for both the present and the future, independent of new IDNOs or activities of existing ex-PES DNOs and therefore provides the best enduring solution.

*Views invited*

Views are sought on whether SLC 2 powers should be applied to switch on Section C conditions or whether further licence conditions should be included within the IDNO licence. Ofgem will consider representations made to this consultation before reaching a final decision. Subject to the responses received Ofgem would intend to publish a collective licence modification for all distribution licences as a statutory consultation.

Views are welcome on any of the issues raised in this consultation but views are specifically invited on:

- Whether any or all of SLCs 34, 35 and 48 in their current or as modified form should be applied to IDNOs;
- Whether there are any other section C conditions that may be appropriate to include for IDNOs;
- Whether these conditions should also apply to ex-PES DNOs operating out of area; and
- Whether including new SLCs within section B is the appropriate method for modifying the licence for the IDNOs and ex-PES DNOs operating out of area as appropriate.

Responses should be received by 29 April 2005 and addressed to Mark Cox, Distribution Policy, 9 Millbank, London, SW1P 3GE or [distributionpolicy@ofgem.gov.uk](mailto:distributionpolicy@ofgem.gov.uk). Any queries about the topics in this letter should be addressed to Mark Cox at the address above or on 020 7901 7458.

Yours faithfully

Martin Crouch  
Director - Distribution