



DNOs, IDNOs, suppliers,
consumer groups, generators and
other interested parties

*Promoting choice and
value for all customers*

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Dear Colleague,

Electricity Distribution Licence Review (DLR): Conclusions and Statutory Consultation

The Electricity Distribution Licence Review has involved a thorough review of the distribution licence to arrive at a slimmer and easier to use set of standard licence conditions (SLCs). This letter sets out the conclusion of the DLR. It summarises the achievements of the review and highlights policy areas within the licence that could be reviewed at a later date.

Accompanying this letter are several statutory consultation documents, which seek licensees' approval to implement the proposals of the DLR via collective and individual licence modifications. If licensees approve our proposals, they will come into effect on 1 June 2008.

Background

In March 2007 Ofgem launched a review of the SLCs of the electricity distribution licence as part of its commitment to better regulation. The aim of this review was to improve the clarity and ease of use of the licence without substantively reviewing the policy that underlies it. This was the first time that the SLCs of the electricity distribution licence have been reviewed since they were introduced in accordance with the Utilities Act 2000.

The exercise identified potential future policy changes which are explained below.

In order to deliver the DLR, Ofgem has worked closely with a working group consisting of Distribution Network Operators (DNOs), Independent Distribution Network Operators (IDNOs), energywatch and a legal representative from Wragge & Co.¹ This working group has played an integral part in the detailed review of SLCs and the drafting of the new licence conditions.

In October 2007, Ofgem published a consultation document entitled "Electricity Distribution Licence Review: Proposals" (Ref 259/07). It sought views on the proposed licence conditions (PLCs) that the working group had drafted. This consultation closed in January 2008. Since then we have worked closely with the industry to resolve issues that were raised as part of this consultation. This process involved further working group meetings and a public workshop. We are now in a position to introduce the PLCs.

¹ John Cooper from Wragge & Co acted as legal adviser to the Energy Networks Association and worked alongside the working group.

Summary of achievements

The proposed standard licence is almost 50 pages thinner than the existing document and the 77 SLCs have been reduced to 49.

The proposals of the DLR can be explained by considering three general themes: i) making the licence clearer and more user friendly, ii) consolidation and iii) removal of obsolete conditions. Below are summaries of our proposals in relation to each of these themes.

Clearer and more user friendly

The proposed standard distribution licence is written in a clearer more user friendly style in order to make the obligations and provisions clearer to all users of the licence. The SLCs have also been substantially reordered, in places consolidated, and those that are obsolete have been removed. The proposed licence is therefore around a third slimmer.

The proposed licence consists of just two main sections, A and B, rather than the three existing sections. That is, existing Section A (which applies to all licensees but only contains provisions relating to definitions and interpretation) has been merged with existing Section B (which contains general provisions and is also applicable to all licensees) to become the new Section A in the proposed licence. Proposed Section A will apply to all licensees. Proposed Section B, formerly Section C, will only apply to licensees who are Distribution Services Providers (i.e. the DNOs).²

The new licence introduces chapters that group related conditions together under one heading. The individual conditions contain descriptive subheadings to help the reader identify particular obligations and provisions within a condition.

Consolidation

The proposed licence consolidates a number of existing conditions and in some cases captures similar provisions together in 'catch-all' conditions. For example, a single condition now covers the following provisions:

- A single core Industry Code condition (PLC 20) replaces eight separate conditions
- A single condition (PLC 4) replaces the three current separate conditions that relate to the licensee's obligation not to discriminate
- A single condition describing the Functions of the Authority (PLC 7) replaces the four current separate conditions
- A single joint condition for charging methodologies (PLC 13) replaces the current separate conditions covering use of system and connection
- A single condition to govern modifications to the Regulatory Instructions and Guidance documents (PLC 49) replaces the existing four separate conditions.

There have also been some more substantive examples of consolidation, which are outlined below:

The BA conditions - At present the IDNOs have six amended standard conditions in addition to their SLCs. These amended standard conditions can be found in Section BA of their licence. With the exception of BA1 (relative price control) these conditions are very similar to the DNO financial ring fencing conditions in Section C of the licence. Consequently, the working group considered consolidating the Section BA conditions with their associated Section C conditions.

² DNOs evolved from ex-Public Electricity Suppliers. These companies have distribution services areas corresponding to the areas in which they were formally the incumbent. Within these areas they have certain licence obligations. IDNOs do not have distribution services areas.

Following consultation and correspondence with the industry, we propose to consolidate BA2, BA3 and BA4 with SLC's 43, 44 and 45. These consolidated conditions will be placed in Section A of the licence, where they will apply to all both IDNOs and DNOs.

Codes of practice and vulnerable customers - The current licence framework contains requirements for developing and maintaining a series of codes of practice, which address the treatment of vulnerable customers. The requirements for these codes are currently contained within published guidance documents rather than the licence itself. The proposed licence simplifies these arrangements so that all the necessary requirements are contained within the licence. Ofgem and the working group considered it better regulation to have all requirements placed within the main body of the standard conditions.

Removal of obsolete provisions

The DLR proposes to remove the following conditions that are no longer needed:

- SLC 11 which relates to the implementation of the Balancing and Settlement Code
- SLC 12A, 27, 28, 30, 31, 33, 34 and 35 which are no longer in use
- SLC 12 which relates to the Settlement Agreement for Scotland
- SLC 30B which relates to the BETTA run-off arrangements
- SLCs 53A, B and C relate to assistance for high cost distribution areas, which in practice only apply to Scottish Hydro. As part of this review we propose to consolidate these three licence conditions into a single condition, remove it from the standard licence and insert it as a special condition to Scottish Hydro's licence.

Changes since our October 2007 proposals

Since publication of our October 2007 proposal document the working group has made further changes to the PLCs on the basis of responses to that consultation. These changes can be found in our 'Log of changes to DLR proposals', which is a schedule to the CLM that accompanies this letter, and in a change-tracked copy of our proposals, which is attached as Appendix 1 to this letter. A summary of the main changes is set out below:

BA conditions

As part of our October proposals the working group had proposed to amalgamate all current BA financial ring fencing conditions (ie BAs 2-6) with their DNO equivalent conditions in Section C of the current licence (ie SLCs 43-47). The working group also proposed to consolidate the relative price control provisions for DNOs operating out of area (special condition G1) and for IDNOs (BA1). The consolidated conditions would become SLCs and be placed in Section A of the proposed licence.

The proposal to consolidate these conditions would result in separate IDNO and DNO obligations sitting alongside each other in the same licence condition. Consequently, it was thought IDNOs may lose their individual voting rights on these consolidated provisions as they would become subject to the terms of Section 11A of the Electricity Act 1989, ie the collective licence modification (CLM) process.

In response to our October consultation, IDNOs stated that some of the BA conditions were fundamental to the operation of their business. Some IDNOs were subsequently concerned about this change, particularly in relation to BA1 (relative price control), BA5 (Credit rating) and BA6 (Indebtedness). Following correspondence with industry participants, we have decided to retain BA1, BA5 and BA6 as amended standard conditions and to consolidate BA2, BA3 and BA4 with their equivalent existing Section C SLCs. Current BA1, BA5 and BA6 will be renumbered as BA2, BA3 and BA4. This means that under our proposals, IDNO's licences will consist of a section A and B, and a smaller section BA.

PLC 'X'

Alongside our October proposals to consolidate all of the BA conditions with their equivalent DNO conditions, we proffered a Special Modification Power that would resolve the IDNO concerns in relation to voting rights – see above (PLC 'X'). Our current proposal now involves bringing only three of the BA conditions into section A of the new licence and the differences in DNO and IDNO obligations within these consolidated conditions are very small. As a result PLC 'X' is no longer necessary and it does not form part of the DLR proposals.

Non-discrimination

The current licence includes provisions that in some circumstances state that the licensee shall not discriminate or show preference to any other parties or persons, and in other circumstances that they shall not unduly discriminate or show undue preference. The working group considered that there was no difference between the two provisions and so as part of our initial proposals, we consulted on changing all non-discrimination provisions to “shall not unduly discriminate or show undue preference”.

However, respondents to our October 2007 consultation document considered that our proposal would have the effect of reducing the obligation on licensees in some circumstances. Given that our proposal was interpreted as a policy change, we reassessed it and now propose to revert to the requirements in the current licence, which in our view is the most prudent way forward.

Definition of connection

The current licence does not define ‘connection’. Our October proposals document consulted upon the basis of a new definition being included within the proposed licence. However, we have removed this new definition from our final proposals because we are concerned that it may unnecessarily limit the meaning of what a connection is. We do not think this is appropriate at this time and are keen to consider a definition of connection alongside other significant projects relating to competition in connections. Our commitment to work in this area was recently explained in our March 2008 initial consultation on the Electricity Distribution Price Control “Electricity Distribution Price Control Review: Initial Consultation Document” (Ref 32/08)³.

Possible Future changes

Whilst the scope of the DLR was not to make any policy changes, it has highlighted areas where changes could be made in the future. Some of these are summarised below:

Notice of use of system charge changes for IDNOs - Currently all licensees are required by SLC 4A(5) to provide three months notice (to both users of its system and the Authority) of changes to their use of system (UoS) charges. In order to comply with the requirements of BA1/G1⁴ and the relevant objectives outlined in SLC 4(3), IDNOs and DNOs operating out of area tend to adopt the host DNO's UoS charges.

This has an impact on the ability of the IDNO or DNO operating out of area to provide three months notice of UoS charge changes. That is, in order to meet their obligation under SLC 4A(5) they would have to amend their charging statement and issue notice on the same day that they received notice from the host DNO of changes to its charges. Given that the IDNO or DNO operating out of area may have networks in a number of Distribution Service Areas (DSAs) this task is likely to be unrealistic.

³ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=18&refer=Networks/ElecDist/PriceCtrls/DPCR5 P49-51> specifically detail our thoughts on connections

⁴ BA1 is an amended standard condition which acts a relative price control on IDNOs. It states that the standing charge, unit rate and any other component of charges shall not exceed the distribution use of system charges to equivalent domestic customers. G1 states exactly the same and acts as a relative price control for any DNOs who operate out of area.

As part of this review we invited opinions on whether the obligation in SLC 4A(5) should be amended for IDNOs. Suppliers considered that they were uncomfortable at losing the 3 months notice from IDNOs as they could not always be confident that an IDNOs charge structure would replicate that of the host DNO. Other respondents stated that they felt this change should be taken forward outside of this review to ensure it was developed and consulted on properly. We have therefore decided to pursue this issue outside of this review.

Review of P2/6 - In August 2007, Ofgem published an open letter concerning engineering recommendation P2/6.⁵ This letter sought views from industry on i) the current requirements on licensees in relation to network planning and ii) whether there was a case for reviewing Engineering Recommendation P2/6 (ER P2/6).

We had considered completing this work as part of the DLR. However, given that the scope of this work is likely to be broad, involve significant input from Ofgem and industry participants and potentially result in policy changes, we have concluded that this project should be taken forward in the coming months outside of the DLR.

Codes of Practice - During the process of amending the codes of practice conditions, the working group considered incorporating licence changes related to the recently introduced Consumers, Estate Agents and Redress (CEAR) Act 2007. It is likely that the CEAR Act 2007 will result in the removal of the compliant handling obligations. However, as detailed in a recent open letter entitled "Consumer representation – Licence conditions and Industry codes"⁶, we intend to make all necessary changes to all licences in a single coordinated manner later this year.

Statutory Consultation

Both the working group and respondents to our October proposals consider that this review has delivered a vastly improved set of SLCs in terms of a clearer licence with no obsolete conditions and where obligations are appropriately grouped. Ofgem would like to thank all those who have participated in the DLR over the last fourteen months. We appreciate the time and effort you have committed to helping deliver this important piece of work. This project is a fine example of how joint industry working can further the aims of better regulation. We are keen for all parties to adopt the PLCs resulting from the review.

Alongside this letter, Ofgem has issued several statutory consultation documents on our proposals. These consultation documents seek licensees' representations and approval to the entire package of PLCs. We look forward to receiving responses on our proposals by **29 May 2008**. Responses should be sent electronically to distributionpolicy@ofgem.gov.uk.

Any questions on this document or on our proposals should be directed to either Nicholas Rubin (0207 901 7176) or Mark Askew (0207 901 7022).

Yours faithfully,



Rachel Fletcher
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⁵ Document was entitled "Electricity Distribution Network Planning – Engineering Recommendation P2/6" (Ref 196/07). It can be found at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=19&refer=Networks/Techn/TechStandds>

⁶ [http://www.ofgem.gov.uk/Markets/RetMkts/Compl/ConsRep/Documents1/Licence_changes_open_letter_\(final\).pdf](http://www.ofgem.gov.uk/Markets/RetMkts/Compl/ConsRep/Documents1/Licence_changes_open_letter_(final).pdf)