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Dear Hannah

ARRANGEMENTS FOR RESPONDING IN THE EVENT THAT AN ENERGY NETWORK COMPANY EXPERIENCES DETERIORATING FINANCIAL HEALTH

I write in response to your consultation and draft guidance published in May and the opportunity to comment on the proposals.

General comments

We support your confirmation that Ofgem's duty to present and future customers is supported by the necessary processes that ensure that DNOs are able to finance their activities. Equally, Ofgem also has a duty to allow licensees to be able to finance their obligations. This responsibility should be considered in two parts:

1. Ofgem must satisfy itself that it has set appropriate price controls for network companies. The price controls must recognise the degree of risk via an appropriate cost of capital and the use of the regulatory toolkit for dealing with identified uncertainties.
2. A price control settlement will reflect the anticipated costs and risks at a given point in time. Should there be a material deviation from the circumstances prevalent at the time the price control is set, Ofgem's duty must be to ensure that licensees can still finance their activities.

Introduction and background

In paragraph 1.9, the document states that "where financial distress arises despite the company operating in an economic and efficient manner, Ofgem would consider at its discretion what tools, if any, are appropriate to respond to that distress." This suggests that Ofgem may not provide an efficient company with sufficient revenues. In such circumstances Ofgem would therefore be failing to discharge its duties. Ofgem must recognise that its duty "to current and future customers" may be best served by allowing an efficient company to continue to operate despite an abnormal event. The alternative is for a relatively inefficient company to run the network for future customers. In this instance the most economic outcome will involve some form of protection for the efficient company.

Overview of the guidance document

Question 1: What are respondents' views on the overall structure of the guidance document?

The overall structure is appropriate although a review of other regulators approaches and mechanisms for dealing with financial distress may have provided valuable alternatives and lessons that could be incorporated in this guidance.

Process overview and background information

One of the key issues raised within the chapter is the impact of vertically integrated energy companies. Ofgem must ensure that the ringfence surrounding the Protected Energy Company (PEC) is robust. Customers must be protected from potentially providing support to other business areas where companies have more than one PEC or associated supply/generation activities.

Question 1: Do respondents agree with the stated purpose of the guidance document as set out in Chapter 1 of that document?

1.2.1 The guidance states that this document is intended to address Ofgem's approach to cases of energy administration but the drafting could be amended to reflect that surely not only administration but assistance in the case of financial distress to help prevent administration.

2.5 Regarding the last sentence before 2.5.1 "In order to ensure that this document remains a useful tool for addressing cases of financial distress, it will be necessary to keep the information on network licensees up to date" – It maybe of assistance if the guidance advised how the information will be kept up to date.

Question 2: Do respondents have any comments on the background to energy administration as set out in Chapter 2 of the guidance document?

Ofgem should include deteriorating financial ratios as an important indicator of financial distress. Ofgem include a ratios test within the price control model which should mirror the tests conducted by rating agencies when assessing financeability of the price control proposals.

Pre-administration arrangements

Question 3: Do respondents have any comments on the existing ring fencing provisions?

"...It ensures that those resources are not diverted to any other purpose" sounds too restrictive as dividends for example are allowed to be paid. Perhaps better wording would be that "It ensures that resources sufficient to meet the needs of the regulated business are not diverted to any other purpose".

Question 4: Should there be a condition to reopen a price control for financial distress in the next price control?

We would support the possibility of a DNO specific reopening with the appropriate efficiency considerations. The Ofwat “substantial effect” clause may be an appropriate mechanism to replicate as it allows the water companies, or the regulator, to seek a change in price limits if circumstances beyond the companies’ control change such that the total impact on the company exceeds a threshold in net present value terms. The substantial effect clause is a well understood regulatory mechanism which should be transposed into DPCR5. We would suggest that the materiality level should be set at 10% of company turnover. Ofgem should also recognise that the Ofwat risk management mechanisms are never cited as dampeners to the cost of capital.

I hope our comments and suggestions where relevant are of assistance.

Yours sincerely

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