

Arrangements for responding in the event that an energy network company experiences deteriorating financial health

Document Type: Decision Document

Ref: 123/09

Date of Publication: 12 October 2009

Target Audience: All network licensees. Network company investors, debt holders and equity analysts. Consumer groups, suppliers, generators and gas shippers. All other interested parties.

Overview:

This decision document accompanies the publication of version 1 of our guidance document setting out our arrangements for responding in the event that an energy network company experiences financial distress. This includes a number of changes to our draft guidance document having incorporated respondents' views.

A number of aspects of the guidance document relate only to protected energy companies (PECs). The document provides guidance on the procedures Ofgem may use, including in the event that a PEC is placed into energy administration.

The document and the associated exercise have not been prompted by concerns about any particular network company.

Contact name and details:

Hannah Nixon - Partner, Regulatory Review
Grant McEachran - Senior Manager, Transmission Policy

Tel: 0207 901 7165 / 0141 331 6008

Email: hannah.nixon@ofgem.gov.uk / grant.mceachran@ofgem.gov.uk

Team: Local Grids and RPI-X@20

Context

Our primary statutory duty is to protect the interests of existing and future consumers. Should the financial position of a network company deteriorate, that company may struggle to continue to invest appropriately and maintain its network and deliver acceptable network performance and customer service. If those conditions prevail over time it may threaten the security and reliability of that network company's customers' energy supplies.

The legislative and regulatory framework in place for Britain's energy networks is designed to manage the risk of financial distress affecting network operators harming consumers. This framework provides for a suite of arrangements designed to manage the risks to and impact of deteriorating financial health on consumers.

In December 2008 we published a Position Paper. The Position Paper set out our intention to develop a guidance document outlining the arrangements in place to respond to the deteriorating financial health of a network company and to test this by running a simulation or 'War-Games' exercise. In May 2009 we published a draft guidance document and an associated consultation paper. The consultation paper sought views on all aspects of the draft guidance document.

This decision document accompanies the publication of version 1 of our guidance document. This version contains a number of changes to the draft guidance document to reflect respondents' views. It is our intention to keep this document under review and if appropriate we will publish an updated version to ensure that the guidance document remains up to date and reflective of the prevailing arrangements.

Associated Documents

- Arrangements for responding in the event that an energy network company experiences deteriorating financial health – Draft guidance document and associated consultation document - Ofgem, May 2009 Ref 49/09
<http://www.ofgem.gov.uk/Networks/Policy/Pages/Policy.aspx>
- Arrangements for responding in the event that a network company experiences deteriorating financial health: Position Paper - Ofgem, December 2008 Ref158/08
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=245&refer=Networks/Policy>
- Supplier of last resort: revised guidance – Ofgem, December 2008
http://www.ofgem.gov.uk/Licensing/Work/Revoc/Documents1/SoLR_revised_guidance_-_December_2008.pdf

Table of Contents

Summary	1
1. Purpose and background	3
Purpose of this document.....	3
Background.....	3
Ofgem's duties	4
2. Overall structure and scope of guidance document	5
Summary of draft guidance document	5
Respondents' views.....	5
Ofgem's views	7
Changes to the guidance document.....	9
3. Pre-administration arrangements	10
Summary of draft guidance document	10
Respondents' views.....	10
Monitoring arrangements.....	10
Financial ring fence.....	11
Price control reopeners/disapplication	12
Ofgem's views	13
Monitoring arrangements.....	14
Financial ring fencing	15
Price control reopeners/disapplication	16
Changes to the guidance document.....	17
4. Administration arrangements	18
Summary of draft guidance document	18
Respondents' views.....	18
Stages of energy administration	18
Interactions with key stakeholders.....	19
Ofgem's views	20
Stages of energy administration	20
Interactions with key stakeholders.....	22
Changes to the guidance document.....	22
5. Guidance document - Appendices	23
Summary of draft guidance document	23
Respondents' views.....	23
Ofgem's views	23
Changes to the guidance document.....	24
Appendices	25
Appendix 1 - Consultation Questions	26
List of Respondees	28
Summary of Responses	28
Appendix 2 – The Authority's Powers and Duties	29
Appendix 3 - Glossary	31
Appendix 4 - Feedback Questionnaire	33

Summary

Ofgem's principal duty is to protect the interests of existing and future consumers. The implications of a network company experiencing financial distress and struggling to maintain and develop its network may impact consumers through a reduction in service and/or reduced security or quality of supply.

We do not consider it should be our aim to rule out all risk of the financial failure of a network company or to bail out a company that has encountered financial difficulties as a result of its own actions (or inaction). The primary responsibility for the financial integrity of a network company lies firmly with that company's management and shareholders. Ofgem's primary responsibility is to manage effectively the risks of deteriorating financial health of a network company impacting on energy consumers.

In addition, we expect protected energy companies (PECs) to act responsibly and to inform Ofgem at the earliest stage possible of any potential or actual financial distress. The earlier that a case of financial distress can be identified, the more response options we have available that may help to mitigate and/or contain the situation.

Arrangements for responding to financial distress

We consider that we have robust arrangements in place that manage effectively the risks to and impact of deteriorating financial health of a network company on consumers. These arrangements are well understood by those companies and include:

- requirements on companies to provide to Ofgem on an ongoing basis a series of statements providing details of their financial health – these include an annual 'Certificate of Availability of Resources', which requires each company to provide a certificate, signed by a company director, setting out that the directors of the licensee have a reasonable expectation that the licensee will have sufficient financial resources and financial facilities to enable it to carry out its activities for a period of 12 months;
- procedures for collecting and monitoring additional network company financial and operating data;
- financial ring-fencing conditions, which place constraints on the operation of network companies including provisions for cash-lock up;
- provisions for reopening/disapplying price controls; and
- the ability, with the consent of the Secretary of State, to apply to the Court to place a PEC into energy administration.

These arrangements are set out in a range of documents. In the interests of better regulation, in particular transparency, we consider there to be merit in developing and publishing a single guidance document. The purpose of the guidance document is to set out the arrangements we have in place to respond to the deteriorating financial health of a network company. We have tested these arrangements via a simulation exercise. We have also published a draft guidance document for consultation and have made changes to the final version of the guidance document to reflect a number of respondents' comments. We are now publishing version 1 of the guidance document.

We note that a number of the arrangements do not apply to all network licensees. Most notably, the energy administration arrangements only apply to PECs. PECs are holders of a licence granted under:

- section 6(1)(b) or (c) of the 1989 Act (transmission and distribution licences for electricity); or
- a licence granted under section 7 of the Gas Act 1986 (licensing of gas transporters).

This relates to all licensed parties participating in the transmission or distribution of gas and electricity including independents such as Independent Gas Networks (IGTs) and Independent Distribution Network Operators (IDNOs). It excludes the operators of electricity and gas interconnectors who are licensed under section 6(1)(e) of the 1989 Act and section 7ZA of the Gas Act 1986 respectively.

The primary focus of the guidance document is the arrangements that apply to PECs.

Disclaimer

Any case of network company financial distress or failure that occurs will likely turn on its own particular facts. As such, the guidance document published alongside this document is not intended to fetter the scope of the Authority's powers or the exercise of its discretion whether under licence, statute or otherwise. This document should not create any legitimate expectation that specific cases will be dealt with in a particular manner. References to primary and secondary legislation, licence conditions and other documents that are publicly available are high level references only and are not a substitute for the primary text.

1. Purpose and background

Chapter Summary

This chapter sets out the purpose of this document. It also sets out the background to this work area.

Purpose of this document

1.1. We have today published a document setting out, for guidance purposes, the arrangements we have in place to respond to the deteriorating financial health of a network company. The primary focus of the guidance document is the arrangements that apply to a 'protected energy company' (PEC). The Energy Act 2004¹ defines a PEC as the holder of a licence granted under:

- section 6(1)(b) or (c) of the 1989 Act (transmission and distribution licences for electricity); or
- section 7 of the Gas Act 1986 (licensing of gas transporters).

1.2. The primary purpose of this document is to summarise responses to the draft guidance document published in May 2008 and to highlight areas where the final version of the content of the guidance document has changed to reflect issues raised by respondents.

Background

1.3. Financial distress describes a situation where an affected party cannot access the financial resources required to discharge its obligations. In the case of a network company, this means that they may struggle to finance their licensed activities.

1.4. We have arrangements in place to address a case of financial distress. These include ring-fencing licence conditions and associated monitoring arrangements, enforcement actions and the option of re-opening a price control during a regulatory period. The arrangements also include an energy administration regime established through primary legislation in the Energy Act 2004. The aim of the energy administration regime is to ensure that essential services to consumers remain secure and uninterrupted in the event of a PEC becoming insolvent.

1.5. While there have been a number of significant company failures in the energy sector, no PEC has faced a period of significant financial distress since privatisation. Consequently, the arrangements for dealing with a PEC in financial distress and the energy administration regime are untested.

¹ Sections 154-156: http://www.opsi.gov.uk/acts/acts2004/ukpga_20040020_en_1

1.6. In December 2008, we published a Position Paper setting out the arrangements for responding in the event that an energy network company experienced financial distress. As set out in that paper, given the increased risk associated with the prevailing economic conditions, in particular recent events in the capital markets, we consider it important to test and review the existing arrangements for monitoring and responding to the financial distress of a network company to make sure these are as robust as possible.

1.7. As a key part of the proposed approach to testing the existing arrangements, we stated that we would develop a guidance document that would be tested by running a simulation or 'War-Games' exercise. We also stated that we would publish a draft version of the guidance document for consultation.

1.8. In May we published a draft guidance document and associated consultation paper. The consultation set out an overview of the draft guidance document and set out the issues on which we were particularly interested in hearing stakeholder views. We noted our intention to finalise the guidance document following the consultation process.

Ofgem's duties

1.9. Ofgem's principal duty is to protect the interests of consumers, existing and future. The implications of a network company experiencing financial distress may directly impact consumers. In addition, Ofgem has a duty to secure that licensees are able to finance their obligations under the Gas Act and Electricity Act. This does not mean Ofgem would provide regulatory relief to alleviate financial distress in all circumstances. We would consider why a licensee faced financial distress and to what extent they had acted reasonably and had financed and operated the relevant network efficiently. Network licensees have an obligation to develop and maintain efficient and co-ordinated systems. 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.

1.10. Further information on our duties and powers is set out in Annex 2.

2. Overall structure and scope of guidance document

Chapter Summary

The chapter summarises respondents' views on the overall structure and scope of the draft guidance document. It sets out Ofgem's views on those points and details the changes made to the guidance document.

Summary of draft guidance document

2.1. The draft guidance document was divided into three main parts.

- Part 1 - a Process Overview setting out the key sections of the guidance document.
- Part 2 - the main body of the document setting out the actions that Ofgem may take both pre-administration and during administration to address a case of financial distress.
- Part 3 - a series of appendices setting out additional information on the arrangements for responding to financial distress including the legal framework and an outline of the companies impacted by the guidance document.

2.2. The Process Overview comprised of two chapters. Chapter 1 set out the purpose of the draft guidance document. The purpose was identified as being to set out, for guidance purposes, a detailed response plan to a case of financial distress. Chapter 2 set out the background to the energy administration regime including the core concepts relevant to financial distress and an overview of the energy network operators to whom the process document will apply.

Respondents' views

2.3. All eleven respondents, nine of which were non-confidential and which are published on Ofgem's website, were generally supportive of the purpose of the guidance document and its content. Various respondents commented that the document was clear, logical and comprehensive. It was noted that the document covered the key areas relevant to responding to a case of financial distress. One respondent proposed that the purpose should be amended slightly to clarify that it addresses not only Ofgem's response to cases of energy administration but also the aim of preventing administration.

2.4. One respondent suggested the guidance document should provide added clarity as to which elements of the arrangements apply to all energy network companies and which elements apply only to PECs. Another respondent considered that the guidance could be clearer that it relates to arrangements covering all network operators licensed under the Gas and Electricity Acts.

2.5. One respondent commented that PECs might become distressed through a combination of factors but that if a single factor is the cause of the distress, then it is quite likely that the distress will be felt by more than one PEC. On a similar vein respondents proposed that the guidance document would benefit from addressing whether Ofgem's approach would be different if more than one PEC were to experience financial distress simultaneously.

2.6. Another respondent expressed the view that Ofgem could fail to discharge its duty "to existing and future customers" if it offered assistance that allowed a relatively inefficient company to run the network, but did not aid the continued operation of an efficient company that had suffered an abnormal event.

2.7. One respondent said that the background was a helpful overview of administration arrangements, whilst another believed that the word "safe" should be added to the sentence "... the PEC's system is, and continues to be, maintained and developed as a [safe], efficient and economical system."

2.8. One respondent set out the view that the appointment of an energy administrator would mean that consumers' interests would be put first and that this would have implications for the positions of bond holders.

2.9. A number of respondents highlighted other areas that should be addressed by the guidance document including:

- Ofgem's response to problems with continuity of service or quality of service caused by financial distress;
- consideration of the financial health of major generation companies; and
- the approaches of other regulators.

2.10. One respondent argued that it was good practice to periodically review all regulatory arrangements. Another respondent considered that the final guidance paper should be reviewed periodically and updated following consultation. A third respondent proposed that the plans should be reviewed over the next eighteen months as the banking crisis moves towards resolution. A fourth respondent sought clarity on the process for addressing the questions raised by respondents.

2.11. One respondent considered that a review of other regulators approaches and mechanisms for dealing with financial distress may have provided valuable lessons for the guidance document.

2.12. Another respondent sought further details of the 'war-games' exercise and, in particular, whether the exercise has altered Ofgem's guidance.

Ofgem's views

2.13. We welcome the support for the purpose of the guidance document. We agree with the respondent that the document is not only concerned with energy administration but is also concerned with the pre-administration arrangements. However, we do not agree it is Ofgem's responsibility to prevent a company going into administration, particularly where that company has not operated efficiently. Further, we note that the purpose does not state that energy administration is the only course of action but rather that it is a response plan to cases of financial distress including pre-administration procedures.

2.14. In relation to the range of licensees to which the document applies, we agree that further clarity could be provided on which sections only apply to PECs. The sections on financial ring-fencing provisions, price control reopeners/disapplication request, energy administration and some aspects of monitoring only apply to PECs. For the most part, all other aspects apply to all network licensees who can be defined as all network operators licensed under the Gas and Electricity Acts.

2.15. We note the issues raised regarding differences of approach if multiple PECs faced financial distress. We agree that, in some cases a cause of financial distress may impact more than one party. For the most part we expect the measures for dealing with the financial distress of multiple PECs would be broadly the same as those for dealing with a single case of financial distress, though each case would likely turn on its own facts and be considered on the merits. Further, the arrangements have been designed and tested to be robust against multiple cases of concurrent financial distress.

2.16. In response to the point regarding our duty to protect customers, the guidance document is clear that it is not Ofgem's responsibility to protect inefficient companies. It notes that the primary responsibility for the financial integrity of a network company lies with that company's management and shareholders. However, where financial distress arises despite the PEC operating in an economic and efficient manner, Ofgem would consider, at its discretion, what tools, if any, are appropriate to respond to that distress. However, each incidence needs to be judged on its own merits.

2.17. We agree with the respondent that safety is an important factor and we consider that the regulatory framework provides strong financial incentives on network companies to strive for greater efficiency whilst still meeting the terms of their regulatory settlements and their legal duties and obligations relating to providing reliable, secure and safe networks. We consider this should be reflected in the background section.

2.18. On the issue of the distinction between energy administration and ordinary administration, we note that the principal objective of an insolvency practitioner appointed as the "energy administrator" is to ensure the network company's system is and continues to be maintained and developed as an efficient and economical system. Therefore, the interests of all other parties are subordinate to this purpose.

2.19. We note that a number of respondents highlighted additional areas which they considered the document should address. We address each of these in turn:

- 1.** In relation to problems with continuity and quality of service we recognise that this may be relevant to financial health as one way in which companies may seek to save costs is by cutting back on service. The quality of service reporting requirements were discussed in draft guidance document in Section 3.1 and in appendix section A.4.3. Therefore, we do not consider that any changes are required to the guidance document.
- 2.** We agree that the failure of a major generation company could have implications for security of supply. However, the guidance document is only intended to address the issue of the financial distress of energy network companies. There are separate arrangements in place for competitive businesses.
- 3.** For the purposes of best practice we liaised with and considered at a high-level the approaches of other regulators in developing our guidance document. We do not consider it would add additional value to include a section on this in our guidance document at this stage but may seek to introduce this in a subsequent version.

2.20. On the issue of reviewing the document, we note that the version published alongside this document is only version 1. We intend to keep the document under review at all times and where changes are required we will seek to bring them forward at the earliest possible opportunity. Where changes are substantial we will, where possible, seek respondents' views before making those changes. This may depend on the context in which the need for change comes to our attention, and it may for example not be possible to immediately consult / amend the guidance document where GEMA is dealing with an actual case(s) of financial distress. In this regard, it is important to note that the guidance sets out GEMA's indicative approach to deal with a case of financial distress - it is possible that GEMA may depart from the guidance in any real time situations that arise. Further, we agree that in the prevailing economic climate it will be particularly important to keep a close eye on developments and to make changes where required. In relation to how respondents' questions will be addressed we note that this decision document seeks to address these questions. Where we consider the points raised merit further clarity then associated changes have been made to the guidance document.

2.21. Finally, in relation to the request for further details on the 'war-games' exercise. The exercise was run on 12th and 13th March 2009 in Millbank and took the form of a simulation. Simulated companies were used and during the course of the two days the companies experienced a range of challenges that required Ofgem to respond by using the procedures set out in the guidance document. The exercise highlighted that the guidance document was largely effective and the only changes made were relatively minor with a view to providing additional clarity. The exercise also highlighted a number of areas which we are continuing to consider including a further review of the ring fencing arrangements.

Changes to the guidance document

2.22. Having taken into consideration respondents' views the overall structure of the document remains unchanged. The stated purpose of the document has also not changed.

2.23. The key changes are as follows:

- Summary - confirms that, for the most part, the document sets out the arrangements which apply to all network operators licensed under the Electricity and Gas Acts.
- Section 1.2 - this section provides additional information on which sections of the guidance document apply to all network licensees and which sections only apply to PECs.
- Section 2.3 - the requirement to operate a "safe" network has been added to the description of the network licensees' responsibilities.

3. Pre-administration arrangements

Chapter Summary

The chapter summarises respondents' views on the pre-administration arrangements detailed in the draft guidance document. It sets out Ofgem's views on those points and details the changes made to the guidance document.

Summary of draft guidance document

3.1. Chapters 3 and 4 of the draft guidance document set out a range of potential measures which can be taken to seek to improve the financial health of a PEC that may avoid it being placed into energy administration. These include monitoring financial health, enforcing the financial ring fencing provisions, reopening a network company's price control and/or the trade sale of a company.

Respondents' views

3.2. All eleven respondents commented on the pre-administration arrangements set out in the draft decision document. Of those the majority considered that the document provided an appropriate overview of the individual stages of the pre-administration process. No respondent highlighted additional stages that should be reflected.

3.3. One respondent sought confirmation on the order the stages would follow. It set out the view that Ofgem should evaluate all practical measures to ensure survival of the existing company before considering options such as a trade sale or administration.

Monitoring arrangements

3.4. One respondent noted that Ofgem's processes for monitoring financial health were proportionate and do not place undue burdens on PECs. Another respondent considered Ofgem's monitoring arrangements to be very effective.

3.5. One respondent noted that it was not clear where additional monitoring would be able to give additional forewarning of sudden unexpected increases in cash requirements for a PEC such as when it needs to refinance debt unexpectedly, to fund a material increase in pensions deficit triggered by an actuarial review or an expected source of cash becomes unavailable.

3.6. A number of respondents proposed that Ofgem should provide additional information including:

1. Ofgem should disclose its monitoring arrangements in greater detail, so that it is clear when actions are likely to be triggered;
2. how Ofgem's information about the financial health of the network licensees will be kept up-to-date; and
3. where financial distress becomes apparent, Ofgem's guidance document should consider the "active steps Ofgem will take, on behalf of consumers".

3.7. One respondent considered that financial ratios were an important indicator of financial distress and that a ratios test should be included in financial stability evaluation which should mirror the tests conducted by ratings agencies when assessing financeability of the price control proposals.

3.8. Another respondent highlighted some of the risks associated with derivatives and consequently set out the importance of improved reporting and disclosure of derivatives.

3.9. A third respondent commented that Ofgem's processes should take account of the banking crisis and in particular the combined impact in compressed timescales of an increasing cost of capital, reduction in the amount of capital available and the expectations that lenders to network companies may require shareholders to forego distributions.

Financial ring fence

3.10. One respondent considered the financial ring fence arrangements to be effective and in line with best practice in other regulated sectors. However, a number of respondents outlined what they considered to be limitations of the existing ring fencing arrangements. One respondent said that the 'Availability of Resources' statement may add little to the protection derived from the fact that accounts are already signed off on the basis of the going concern principle. Another respondent who supported the existing financial ring fence arrangements argued that changing to, or consideration of changing to, other financial structures could pass risk to customers from debt or equity holders. A third respondent highlighted the potential risk posed by sustained deflation reducing both revenues RAV values. The respondent noted it as a factor which could make it harder to raise finance and also increase gearing, the latter of which could lead to reduced credit ratings and/or breaches of bank covenants. It noted that three water companies have had to raise additional finance this year.

3.11. One respondent expressed concern at the implications of licensee ownership. It believed that licensees could be vulnerable, because the cash lock-up and the financial ring fence depend upon credit ratings (called into question owing to their role in credit crisis) and rely on the integrity of the licensees' directors when providing certificates that might not be sufficient to prevent payments out of a PEC before the lock-up is triggered. On the second point, it suggested that the

certification process that precedes the payment of dividends might be enhanced for those licensees that are part of groups whose financial strength is questionable, which might be preferable to Ofgem becoming more prescriptive about the capital structure of the licensee or of a group that owned a licensee.

3.12. On a similar vein, another respondent expressed concern at the suggestion that a PEC's financial distress can stem from its group, asking for clarification and suggesting that the financial ring fence might need to be tightened if necessary. This was echoed by another respondent, concerning vertically integrated energy companies that have more than one PEC or associated supply/generation activities.

3.13. Another respondent set out the view that the presently stated purpose of the ring fencing provisions (to ensure "resources are not diverted to any other purposes") was too restrictive and should be changed to "ensures that resources sufficient to meet the needs of the regulated business are not diverted to any other purposes."

3.14. One respondent considered that the risk of energy administration could be reduced via reinforcement of the regulatory ring fence criteria. The respondent argued clear backstop-type financial trigger ratios would best achieve this aim, to complement the role of rating agencies, with either/or being a trigger.

3.15. A number of respondents sought Ofgem's views on aspects of the existing arrangements including whether warning signs from financial monitoring are viewed as complimenting events such as the failure to provide ring fencing certification. Another respondent asked, in the context of independent distributors, about Ofgem's view on the relationship between ability to set charges at a level that reflects costs and the prospect of obtaining a credit rating.

Price control reopeners/disapplication

3.16. Two respondents stated that the current triggers for reopening / disapplying price controls are reasonable. However, one of those respondents considered that the emphasis should be on the speed of action by both the PEC in trouble and Ofgem. A third respondent noted that the timetable for a disapplication process instigated by the licensee (18 months) is too slow to help avoid financial distress, and instead recommended setting up a fund to provide aid to PECs at short-notice. The respondent considered this would also be a cheaper process.

3.17. A number of respondents sought further clarity on the criteria Ofgem would apply in deciding whether a price control would be disapplied. One respondent considered that requests should only be considered where the PEC had been 'subject to adverse events demonstrably outside of management control' and where they had tried all other routes before asking for disapplication. The same respondents noted that energy administration and the revaluation of the PEC's assets could offer a better deal for customers. Another respondent proposed that, in reviewing a request to reopen/disapply a price control, Ofgem should consider whether the circumstances that brought about that distress would apply to other licensees and thus whether any

increase in the allowed revenues of a stressed licensee should apply to other licensees. The same respondent noted that if, however, the distress was due to poor management then there should be no price control reopener, but other measures such as energy administration or a trade sale may be appropriate.

3.18. Two respondents highlighted the level of risk an energy network company faces would be an important consideration in determining whether to reopen or disapply a control. One respondent noted that a disapplication should not be granted if distress was due to movement in risk for which adequate provision had been made in setting the control. The other respondent suggested that Ofgem must be satisfied that the price controls properly recognise the degree of risk via an appropriate cost of capital, that they can deal with identified uncertainties, and that they must be altered if circumstances change materially. The same respondent also noted that in reviewing a price control, Ofgem should ensure that risk, reward and performance are balanced such that any reduction in risk and/or performance that is allowed by an interim review is balanced by a commensurate reduction in reward.

3.19. One respondent supported the addition of a condition to reopen a price control for financial distress in setting future price controls. The respondent cited Ofwat's "substantial effect" clause which allows for a change in price limits if the impact of a change caused by circumstances beyond the company's control exceeds a threshold in net present value terms. The respondent proposed a threshold of 10% of company turnover for these purposes. In response to possible criticisms of this approach, the respondent pointed out that the risk management mechanisms of Ofwat's price control settlement are not cited as dampeners to the cost of capital.

3.20. One respondent noted that an external reason for reopener would probably affect all PECs, so all price controls should be reopened. If, however, the distress was due to poor management then the respondent considered that there should be no price control reopener, just energy administration, trade sale, etc.

3.21. A number of respondents made points specifically concerning IDNOs and IGTs. One respondent asked Ofgem to confirm that IGTs and IDNOs (none of whom presently have formal credit ratings) are deemed eligible for a price control reopener or disapplication. Another respondent argued that IDNOs and IGTs (unlike other PECs) have no presumed right to pass on exogenous costs, and asked Ofgem to indicate whether the form of price-control itself could lead to financial distress.

3.22. Another respondent asked that the reference to consulting "where appropriate" on a reopener or disapplication request be replaced with a commitment to consult on interim review proposals at key stages of the process wherever possible, and an explicit commitment to be transparent in all aspects of the process.

Ofgem's views

3.23. We note the general support of respondents for the overview of the individual stages of the pre-administration process.

3.24. In relation to the issue of how the stages would be followed we note that the order may vary from case to case. In some cases stages may be skipped due to the rate at which a company's financial position is deteriorating. However, in taking forward these stages we note that we do not consider it Ofgem's role to "ensure survival of an existing company". It may be the case that a company has operated inefficiently in which case it is not Ofgem's role to ensure its survival but rather to ensure that the interests of consumers are protected.

Monitoring arrangements

3.25. We recognise the view that increased monitoring might not be able to give adequate additional forewarning of sudden financial distress. There are clearly limitations to what can be achieved by monitoring and indeed sudden changes would be more difficult to predict. However, where Ofgem identifies a specific concern, or during periods of particular economic concern, Ofgem may increase monitoring to identify potential problems. By doing so it is possible that issues such as additional refinancing needs may be identified at an earlier stage.

3.26. We note that a number of respondents highlighted additional areas which they considered should be addressed in the section on monitoring arrangements. We address each of these in turn:

- 1.** In relation to providing more detail on monitoring the guidance document is concerned with setting the procedures that Ofgem will consider applying in responding to circumstances where a PEC faces financial distress. It is not therefore concerned with the specific details of the monitoring arrangements. We have sought to provide a high-level overview of Ofgem's monitoring arrangements to provide a guide as to the approach Ofgem adopts. However, we do not consider that providing more detail of our monitoring arrangements would aid licensees in their actions.
- 2.** On the issue of updating licensees' information we note that in addition to the review of the companies' reporting requirements, we collect and assess a range of other information. This includes general market indicators such as share prices and credit ratings. In doing so we seek to keep an up to date record of the financial position of licensees.
- 3.** Where financial distress becomes apparent there are a number of steps we may take including increased monitoring, engaging with the company, enforcement of the financial ring fence and considering the merits of changes to a price control or applying for an energy administration order. We consider that the guidance document already sets out sufficient details on these areas and therefore do not plan to make any additional changes to the guidance document in this respect.

3.27. On the issue of financial ratios we note that we do have in place a series of financial ratios which we use to monitor the financial health of network licensees. We also seek additional information from the ratings agencies where appropriate.

3.28. In relation to derivatives we note the risks highlighted by the respondent. We note that we collect some information on derivative positions as part of the regulatory reporting processes. However, we will further consider the extent to which enhanced reporting in this area would be appropriate.

3.29. In terms of the impact of the current banking crisis, we agree that Ofgem's processes are affected by such issues and we increase our level of monitoring at such times. We also initiated the current review in response to the additional challenges presented by challenging economic times.

Financial ring fencing

3.30. We recognise there are interactions between the financial health of different parts of a group or a vertically integrated company. The financial ring fence arrangements are designed to ensure these pressures do not affect the financial health of a network licensee. Further, we note that another respondent supported backstop-type financial trigger ratios. We will continue to keep the financial ring fencing arrangements under review and if we consider any aspects of those arrangements do not provide adequate protection then we would seek to bring forward appropriate changes to address those concerns.

3.31. In terms of the interaction between different signals of financial health we note that there are a range of potential signals of deteriorating financial health. Two sources of such information are the financial monitoring arrangements and the ring fence arrangements. We agree with the respondent that these arrangements, when taken together, can build up a better picture of a company's financial health.

3.32. We note that licensees highlighted a number of perceived limitations of the ring fencing arrangements. On the role of the 'Availability of Resource' certificate we note that it is due not only on an annual basis, but in cases where the company intends to pay a dividend. As such it may provide more frequent assurance that the company has sufficient resources than the annual accounts. In terms of making any changes to the financial ring fencing framework, we note that Ofgem does not intend to make changes to the financial ring fence that would pass risk to customers from debt or equity holders.

3.33. In relation to the issue of licensee ownership and its impact on licensees' financial positions, we note that we are reviewing the continuing appropriateness of the financial ring fence conditions. We note that in practice credit ratings still play a significant role in the financial markets' assessment of a company's creditworthiness and to this extent they continue to provide a useful reference point for Ofgem. We recognise that the credit ratings systems, designed as they are to provide a stable long-term view of a company's creditworthiness, may not always respond quickly enough to a rapid deterioration in a company's situation for our purposes, which is a factor in our setting up enhanced monitoring of energy network companies. It is not clear what enhancements to the certification process the respondent envisages, but it would not be appropriate for Ofgem to formally sanction dividend payments.

3.34. We agree with one respondent that the drafting on the purpose of ring fence set in the draft guidance document was too tight and will amend this accordingly.

3.35. On the issue of the risk posed by deflation, we have undertaken analysis and consider it is unlikely that a deflationary period would lead to a substantial deterioration in the licensees' financial structure compared to their current structure. However, we note the issue and intend to keep this under review.

Price control reopeners/disapplication

3.36. We note the issues raised regarding the timetable implications of price control reopeners/disapplication requests. We agree that the speed of response to a case of financial distress is important. We will add wording to reflect the fact that we will seek to progress matters in a timely manner consistent with completing the necessary steps involved in this process. In relation to the 18 month period for the disapplication process, we note that this reflects the maximum period that can be taken to address disapplication requests. In the event of a case of financial distress we would seek to progress the issue in a timely manner. We note the proposed approach of establishing a fund to provide aid to PECs at short-notice and indeed the document recognises that funding is one option to provide financial support to a PEC outside of administration. However, there are mechanisms for doing so and we do not consider establishing a specific fund for this purpose is either necessary or appropriate.

3.37. We note there were a range of views on the criteria Ofgem would apply in deciding whether a price control would be disapplied including the treatment of risk in setting the cost of capital. In setting a price control Ofgem seeks to provide a level of return sufficient to allow the licensees to meet their regulatory obligations while seeking to reflect the risks they may face during the regulatory period. This includes setting an appropriate level of reward commensurate with outperforming the control. We recognise that there could be circumstances where changes are not within the control of the management of network companies and were not envisaged and therefore not provided for in the price control settlement. It is for these reasons that it is appropriate to have provisions for price control reopeners and disapplication. However, we agree that considerations relevant to whether a price control should be reopened or disapplied should include:

- whether the factors causing financial distress were within the control of the licensees' management team;
- whether the licensee had taken appropriate measures to avoid financial distress; and
- whether sufficient provision had been made for the type of risk in setting the control.

3.38. We have reviewed the pre-administration arrangements in the guidance document to include these factors.

3.39. In terms of the relevance of a model for reflecting efficiency considerations such as Ofwat's "substantial effect", we note that the important consideration is the reason for the reopener/disapplication request, i.e. whether it is beyond the company's control rather than its magnitude.

3.40. On the issue of consulting on a price control reopener, Ofgem seeks to be transparent in undertaking its responsibilities and we recognise that a key element of transparency is consultation. However, it is also important that decisions are made in an efficient and timely manner and consultation may not be appropriate in all instances. We therefore consider that "where appropriate" should remain in referring to when we will consult.

3.41. In relation to an issue affecting multiple PECs, we recognise that in some cases the cause of financial distress may affect more than one party and there may be justification for reopening a control for more than one licensee. Further we agree that where distress is due to poor management then reopening a price control is unlikely to be an appropriate action.

3.42. On the issue of the impact of the form of price control on the financial positions of IDNOs and IGTs we note that the price controlled networks that Ofgem regulates do not have a general right to pass on costs, but may have the ability to do so if specific elements of the price control framework allow it. Ofgem has a duty to secure that licence holders are able to finance their activities, which covers IGTs and IDNOs. The licences provide provisions for the disapplication of IGT and IDNO charge restriction conditions.

Changes to the guidance document

3.43. Having taken into consideration respondents' views on the pre-administration arrangements the following key changes have been made to the guidance document:

- Section 3.1 - the wording of the purpose of the financial ring fence has been changed to "It ensures that resources sufficient to meet the needs of the regulated business are not diverted to any other purpose".
- Section 4.3 - additional text has been added to the price control reopener section to clarify the factors that will be considered in determining whether to reopen/disapply a control. In particular to be clear that: (a) factors driving the reopener should be outside the control of PEC management; (b) PECs should examine other routes before asking for disapplication; and (c) disapplication should not be granted if distress was due to movement in risk for which adequate provision has already been made.
- Section 4.4 - additional drafting has been added to the price control reopener/disapplication section to emphasize the importance of taking actions in a timely manner, where possible.

4. Administration arrangements

Chapter Summary

The chapter summarises respondents' views on the administration arrangements detailed in the draft guidance document. It sets out Ofgem's views on those points and details the changes made to the guidance document.

Summary of draft guidance document

4.1. Chapters 5 to 9 of the draft guidance document set out the various stages in the energy administration process. These include applying for an energy administration order, appointing an administrator, the process of the core administration period, facilitating the restructuring/sale of a licensee and the end of the administration process.

4.2. Chapter 10 set out details of interactions between Ofgem and a number of key parties that would be involved in responding to a case where a PEC enters energy administration.

Respondents' views

Stages of energy administration

4.3. One respondent asked when in the process Ofgem / Department of Energy and Climate Change (DECC) would apply for an Energy Administration Order. Another respondent sought clarity on whether Ofgem or DECC would apply for the Order. A third respondent sought further information on the process to be followed if multiple PECs needed to be placed in energy administration.

4.4. One respondent considered that the time period covered by an energy administration episode would have an impact on the regulatory workload that an energy network company was undertaking and that the necessity of its obligations, e.g. producing its Regulatory Reporting Pack (RRP) should be considered.

4.5. One respondent questioned what measures might be taken during the stabilisation stage of energy administration. Another respondent warned of the impacts of an energy administrator reducing capital expenditure on customers. A third respondent sought clarity about the process for recovering funding by DECC/ HM Treasury and whether this was through taxes or network charges.

Sale of a licensee

4.6. Respondents raised a range of issues regarding the sale of a licensee in the event that a network company experienced financial distress. One respondent sought additional details on the process for the sale of a licensee. In particular, the respondent requested information about undertakings that would be required of the ultimate controller of a buyer of a distressed PEC.

4.7. A number of the issues raised by respondents with respect to the sale of a licensee focused on merger scenarios whereby a group already owning a network company sought to buy another network company. One respondent sought clarity on the criteria to be applied where a sale of a PEC to the owner of another licensed network operator is proposed, including Ofgem's view on the potential impact on the PEC's customers of a proposed merger in considering its advice to the Office of Fair Trading or European Commission. Another respondent observed that there are precedents that shed light on the costs to consumers of market concentration (i.e. GDN sales, DPCR4). A third respondent was concerned by the fact that a merger tax could be levied in the case of a sale of a distressed PEC. A fourth respondent noted that if the price control had been re-opened to help operations and to attract a buyer, the buyer would then need guarantees that a price control would not be reopened again after the sale.

4.8. One respondent referred to the indication by Ofgem that trade sales may be a more realistic option for smaller PECs, and said that it would like to understand what threshold Ofgem has in mind. A third respondent questioned what would happen if no buyer can be found, and how energy administration will be ended, suggesting the need for legislation.

4.9. One respondent noted that the IGT UNC should be added to the list of relevant industry codes in Chapter 8.

Interactions with key stakeholders

4.10. One respondent felt that customers should be listed amongst the stakeholders, and that their responsibilities and likely interactions should be clarified including:

- explicitly stating that they will bear the costs;
- clarifying the way in which network charges would be altered to pass on costs (would prefer a smoothed pass-through of costs);
- being clearer about the extent and timing of interactions with customers, and engage in proper (if time-constrained) consultations; and
- giving full disclosure of the nature of the financial distress faced by the PEC, and the nature and implications of the remedies being considered.

4.11. One respondent considered that the role of the pensions' regulator should be considered in cases in which pensions liabilities were the cause of a PEC's financial distress.

Ofgem's views

Stages of energy administration

4.12. In relation to the timing of an application for an energy administration order, it is impossible to determine exactly when in the process Ofgem / DECC would apply for energy administration as the triggers for seeking an Order would vary from case to case. For example, in some cases a licensee's financial position may deteriorate slowly such that they progress through a range of pre-administration arrangements whereas in other cases financial distress would occur very quickly such that an application for an energy administration order is made with little notice. On the issue of who applies for an order we note that either DECC or Ofgem with the consent of DECC can apply for an energy administration order. The default position is that Ofgem would apply.

4.13. We do not consider that the process for placing multiple PECs in energy administration would vary greatly from that for an individual PEC. However, as an individual administrator would have to be appointed in each case (albeit that multiple administrators could be from the same company) then it would become more challenging the higher the number of parties being placed in administration. However, we consider this an unlikely scenario.

4.14. On the issue of the regulatory workload of a company during energy administration we note that the network licences set out the obligations on licensees. During energy administration those obligations, including RRP arrangements, will continue to apply.

4.15. We note that respondents have sought additional detail on the stabilisation stage. The stabilisation period refers to the early stages of the administration process when the administrator is familiarising him or herself with the business and taking any necessary actions to stabilise the immediate financial position of that business. There are limited actions for Ofgem during this stage other than providing the energy administrator with any information required to operate the network company, e.g., information on its licence, its' regulatory reporting requirements and other obligations. We have provided some additional detail to this effect in the guidance document.

4.16. On the issue of the concern raised by one respondent on the impact of an energy administrator reducing capital expenditure we note that any changes in capital expenditure plans would have to be communicated to Ofgem and we would fully consider the implications of such changes including those for customers. It is possible that once a licensee has emerged from energy administration, it would be required to undertake the expenditure necessary to ensure that customers were receiving the same quality of service they would have done had energy administration not occurred.

4.17. In relation to the recovery of costs for energy administration we note that any costs for DECC and HM Treasury are outside the scope of Ofgem's procedures and therefore is not addressed in the guidance document.

Sale of licensee

4.18. In relation to providing more information on the process for the sale of a licensee, we consider that we set out the key stages of the sale of a licensee at a high level in the draft guidance document. Many of the other details will depend upon the specifics of the individual case and therefore we do not consider that any additional details can be provided. Specifically in relation to the undertakings required of the ultimate controller(s) of a licensee we note that no special undertakings are required of a person or company who becomes the ultimate controller of a licensee in financial distress beyond those required in the licence.

4.19. On the issue of mergers we note that the advice provided by Ofgem to OFT or the European Commission will usually be based on the information provided by the relevant parties, our existing knowledge and experience of the sector and analysis of the likely impact of the merger on competition. Ofgem's principal objective is to protect the interests of customers, existing and future, and therefore the impact on customers will be central to that assessment. We have also published guidance on mergers in the electricity distribution sector in 2002² which was subsequently updated in 2005. We also recognise that the costs of market concentration have been considered in previous work as part of GDN sales and DPCR4. We would propose to adopt a similar approach in considering any impact on market concentration as the result of a sale of network licensee.

4.20. In the event that a sale of a licensee resulted in consolidation in the network sector then an adjustment or "merger tax" may be appropriate to price control revenues to reflect any associated detriment to consumers. However, Ofgem would carefully consider the impact of imposing any merger tax and will also consider the potential efficiency savings associated with a sale. The decision on price control re-openers and disapplication requests will be based on the specifics of the case and in particular whether that control provides an appropriate level of return to enable the licensee to meet its regulatory objectives.

4.21. In relation to our previous comment that the sale of a smaller energy company may be more realistic we note that there is no specific threshold between a smaller and larger PEC that we had identified. However, generally the process associated with the sale of an IDNO or IGT would be expected to be more straightforward than that associated with a DNO, GDN or TO.

2

[http://www.ofgem.gov.uk/About%20us/enforcement/mergers/oft/Document s1/mergersandaquisitions%2048.pdf](http://www.ofgem.gov.uk/About%20us/enforcement/mergers/oft/Document%20s1/mergersandaquisitions%2048.pdf)

4.22. We consider it is highly unlikely that no buyer will be found during the period of administration. The energy administration arrangements provide scope to allow a long term solution to be found.

4.23. We agree that the IGT UNC is a relevant code and should be added to the list of codes in Chapter 8.

Interactions with key stakeholders

4.24. We note the views of one respondent that customers should be added to the list of stakeholders. We recognise that customers are key stakeholders and that ultimately they bear the costs associated with any increase in network charges. However, we note that this section was intended to reflect the practical interactions, i.e. where responsibilities lie, between departments in the event of responding to a case of financial distress rather than to provide an exhaustive list of all stakeholders.

4.25. We recognise that there may be issues with existing pension liabilities. The Pension Act 2004 contains provisions relating to the treatment of pension liabilities. We will set out a link to this in the draft guidance document.

Changes to the guidance document

4.26. Having taken into consideration respondents' views on the pre-administration arrangements the following key changes have been made to the guidance document:

- Section 7.1 - additional detail is added to set out the key issues during the stabilisation stage.
- Section 8.2.1 - clarify that Ofgem's principal objective is to protect the interests of customers, existing and future, and therefore the impact on customers will be central to any assessment of a merger provided to OFT or the European Commission.
- Section 8.2.4 - the IGT UNC is added to the list of relevant codes.
- Section 10.1.4 - a new section is added to include reference to interactions with the Pensions Regulator.

5. Guidance document - Appendices

Chapter Summary

The chapter summarises respondents' views on the information set out in the appendices to the draft guidance document. It sets out Ofgem's views on those points and details the changes made to the guidance document.

Summary of draft guidance document

5.1. The draft guidance document contained seven appendices. These were:

- Appendix 1 - an overview of the relevant legal framework.
- Appendix 2 - a summary of the Authority's powers and duties.
- Appendix 3 - a list of the current network licensees and their Group owners.
- Appendix 4 - an overview of Ofgem's monitoring arrangements.
- Appendix 5 - a summary of the financial ring fence arrangements.
- Appendix 6 - a summary of the existing price control arrangements.
- Appendix 7 - a glossary of the key terms used in the guidance document.

Respondents' views

5.2. Six respondents commented on the content of the appendices. Of those none considered that any additional appendices should be added or that any of the existing appendices should be removed.

5.3. Four respondents either felt that the legal framework is properly explained or had no substantive comment. However, one respondent proposed that the legal framework should be enhanced to recognise the role of the competition bodies that would consider a potential merger.

5.4. Two respondents highlighted small changes to the licensee and ownership details. One respondent proposed that the guidance should advise how the information on network licensees would be kept up to date. A number of other respondents highlighted other small errors in the guidance document including omitted chapter references and incorrect licence references.

Ofgem's views

5.5. We welcome the general support for the content and level of detail in the appendices.

5.6. We recognise the role of the competition bodies in the UK and EU in considering a merger proposal. We have added a short section on their role to Appendix 1.

5.7. We appreciate respondents highlighting errors in the draft guidance document and have corrected these, including changes to the lists of group owners, in the final version.

Changes to the guidance document

5.8. Having taken into consideration respondents' views the overall structure and content of the appendices remain broadly unchanged.

5.9. The only changes are as follows:

- Appendix 1 - a new section has been added setting out the interaction with the competition bodies in the UK and the EU.
- Appendix 3 (Table 2) - the list of group owners has been updated.

Appendices

Index

Appendix	Name of Appendix	Page Number
1	Consultation questions	26
2	The Authority's Powers and Duties	29
3	Glossary	31
4	Feedback Questionnaire	33

Appendix 1 - Consultation Questions

1.1. In its consultation document(s) (Arrangements for responding in the event that an energy network company experiences deteriorating financial health – Draft guidance document and associated consultation document - Ofgem, May 2009 Ref 49/09) Ofgem sought the views of respondents about a number of questions as set out below:

CHAPTER: Two

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

Question 2: Do respondents consider that any other aspect of the response plan should be addressed in the guidance document?

CHAPTER: Three

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

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

CHAPTER: Four

Question 1: Do respondents consider the guidance document accurately reflects the individual stages in the pre-administration process as set out Chapter 3? Are there any other stages that should be reflected?

Question 2: Do respondents have any views on Ofgem's existing arrangements for monitoring financial health set out in Chapter 3 and Appendix 5 of the guidance document? Do respondents consider these should be augmented and, if so, in what ways?

Question 3: Do respondents have any comments on the existing financial ring fencing provisions as summarised in Chapter 3 and Appendix 5 of the guidance document? Do respondents consider these are effective? Do respondents consider these arrangements should be augmented and, if so, in what ways?

Question 4: Do respondents have any views on the proposed process and triggers for reopening/disapplying price control as set out in Chapter 4 of the guidance document? Do respondents have any views on potential improvements to these arrangements?

CHAPTER: Five

Question 1: Do respondents consider the guidance document accurately reflects the individual stages in the administration process as set out Chapter 5? Are there any other stages that should be reflected?

Question 2: Do respondents consider that Chapter 6 of the guidance document provides an appropriate summary of the arrangements for appointing an energy administrator?

Question 3: Do respondents consider that Chapter 7 provides an appropriate summary of the key elements of the core administration work?

Question 4: Do respondents have any views on the legal, licensing and price control issues identified in relation to the restructuring/sale of a PEC in Chapter 8?

Question 5: Do respondents consider the arrangements set out in Chapter 9 of the guidance document would provide for the efficient end to an energy administration process?

Question 6: Do respondents consider that Chapter 10 of the guidance document accurately reflects the roles of Ofgem, the Department of Energy and Climate Change (DECC) and HSE in the administration process?

CHAPTER: Six

Question 1: Are there any other aspects of the legal framework which should be covered in Appendix 1 of the guidance document?

Question 2: Do respondents have any views on the accuracy of the list of PECs and other network operators set out in Appendix 2 of the guidance document to whom it is proposed that document would apply?

CHAPTER: Seven

Question 1: Do respondents have any views on the proposed process for finalising the guidance document?

List of Respondees

List	Name
1	CE Electric UK
2	Centrica
3	Electricity North West Limited
4	E.ON Central Networks
5	National Grid plc
6	Northern Gas Networks Limited
7	Scottish and Southern Energy
8	SP Energy Networks
9	Western Power Distribution
10	1 Confidential Response
11	1 Confidential Response

Summary of Responses

Responses received by Ofgem which were not marked as being confidential have been published on Ofgem's website www.ofgem.gov.uk. Copies of non-confidential responses are also available from Ofgem's library.

Responses were summarised in each of the relevant chapter of this document.

Appendix 2 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.³

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly⁴.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them⁵;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.⁶

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

³ entitled “Gas Supply” and “Electricity Supply” respectively.

⁴ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

⁵ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

⁶ The Authority may have regard to other descriptions of consumers.

- promote efficiency and economy on the part of those licensed⁷ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation⁸ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

⁷ or persons authorised by exemptions to carry on any activity.

⁸ Council Regulation (EC) 1/2003

Appendix 3 - Glossary

A

Administration

A mechanism for dealing with an insolvent company whereby a qualified insolvency practitioner is charged with attempting to restructure the company so that it may resume normal trading.

The Authority (Ofgem)

Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by Section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain.

D

DECC

Department of Energy and Climate Change.

E

Energy Administration (Special Administration)

The Energy Act 2004 makes provision for "energy administration" for 'protected energy companies'. The principal objective of an insolvency practitioner appointed as the "energy administrator" is to ensure the network company's system is and continues to be maintained and developed as an efficient and economical system and that it becomes unnecessary for the energy administration order to remain in force by the rescue of the company as a going concern or for the company to be transferred to another company / companies.

G

GB Transmission

The system of high voltage electric lines providing for the bulk transfer of electricity across Great Britain.

H

Health and Safety Executive (HSE)

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

I**Insolvency**

Where a company's liabilities exceed the value of its assets or it is unable to pay its debts as and when they fall due.

O**Ofgem**

See definition of the Authority.

Offshore electricity transmission networks

Offshore electricity transmission networks will be required to transmit electricity from offshore renewable generators to customers via the onshore transmission and distribution networks.

P**Protected energy company (PEC)**

Under The Energy Act 2004, a PEC is a network licensee that holds a licence granted under:

- section 6(1)(b) or (c) of the 1989 Act (transmission and distribution licences for electricity); or
- a licence granted under section 7 of the Gas Act 1986 (licensing of gas transporters).

R**Reopener**

A process to re-set revenue allowances (or the parameters that give rise to revenue allowances) under a price control before the scheduled next formal review date for the relevant price control.

W**War Games Exercise**

A simulation exercise to test the robustness of a set of arrangements.

Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul

Consultation Co-ordinator

Ofgem

9 Millbank

London

SW1P 3GE

andrew.macfaul@ofgem.gov.uk