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Mr Paul Darby
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23rd April 2010

Dear Paul,

Review of the 'Ring Fence' Conditions in Network Operators Licences

Thank you for your correspondence of 3rd March 2010 inviting comments on this consultation document.

Taking each question in turn, the views of Energetics Electricity and Energetics Gas **("Energetics")** are detailed as follows: -

1. Introduction & Objectives

Question 1
Energetics believe that Ofgem have identified the relevant objectives in the context of this particular review.

2. The Existing Ring Fence and Issues Arising

Question 1
The risks identified within the consultation document certainly cover a range of activities and Energetics have identified no further risks to offer in addition to the ones described by Ofgem. However, it's worth commenting that many of these risks are applicable mainly to the DNO's and GDN's and to a far lesser extent, IDNO's and IGT's.
In particular, the concern over a lack of focus on operational risks is clearly more acute for a company with ageing assets and subsequent requirements for significant resources to support these operations.

3. Preferred Approach

Question 1
Energetics believe that the proposed/preferred enhancements could actually detract from the identified objectives on the understanding that independent operators such as ourselves would find it extremely difficult to attract finance into the business due to the existing cash lock-up provisions and the extension of restrictions on granting

security over relevant assets. The independent operators are currently disadvantaged in comparison to the monopoly network operators whereby we don't have an investment grade credit rating and consequently our cost of capital is considerably higher. By limiting the security on offer to potential financers then the independent operators cannot compete effectively into the future.

Question 2
Energetic believe that this approach is rather heavy handed. There have been significant changes to many of the financial regulations over the last few years that have strengthened the responsibilities of Directors and Managers. These changes are incorporated in primary legislation and we would suggest that this should be sufficient to satisfy Ofgem rather than introduce another layer of costs and bureaucracy.

Question 3
The main cost impact would be in the proposed extension to the restriction of granting security over relevant assets. Sourcing debt finance is extremely difficult for independent operators such as Energetics in the current economic climate. As banks emerge from the recession looking to pick-up on 'traditional' lending then it should be no surprise that they will look for security over any borrowings. Extending the current restriction to include the book debtors of the business for the specific purpose of ensuring that the Special Administrator had access to working capital could actually serve to drive some independents into financial difficulty on the understanding that they cannot source affordable finance.

Question 4
Energetics take the view that corporate governance is a matter for shareholders and financial regulators. In the event that this change goes through then it is our belief that it should specify a minimum number of independent directors and also, it should only apply to monopoly network operators on the understanding that the risk of 'conflict of interest' is greater due to the nature of their vertical integration business structures. Such a risk is non-existent across the independent market.

Question 5
Energetics take the view that the Ultimate Controller undertaking should only be re-submitted following any changes to these specific arrangements and not on a periodic interval basis.

Question 6
Energetics believe that it would be better to leave the Ring Fence conditions outside the main licence on the understanding that they will be subject to change over time by not having to go through the more time consuming route of primary licence changes.

Question 7
Energetics agree that any agreed changes should not be retroactive.

Question 8
As stated above in questions 3 & 4, Energetics believe that consideration should be given to the independent market place by recognising that these companies;

- operate within a completely different price control mechanism;
- are much smaller in comparison to the monopoly companies;
- do not have supply, transmission or generator licences;
- may not have investment grade credit ratings to secure affordable finance.

4. *Alternative Options Considered*

Question 1
Energetics take the view that these are probably the only other available options.

Question 2
At a summary level Ofgem has identified the two main 'tools' that could be used to support an efficient business in the form of the price control re-opener and arrangements under Special Administration. The difficulty arises when there is a subjective view on an efficient company in financial difficulty and an inefficient company. If this were to arise, albeit highly unlikely, Ofgem could arguably come under pressure to rescue a perceived inefficient company using one or both of these measures. This could be a strong argument against taking a 'less interventionist' approach.

Question 3
The cost/benefit arguments are centred on the 'worst case' scenario of a major network operator(s) falling into financial difficulty and whilst this is entirely appropriate in the current economic climate, the arguments fail to recognise the impact on day-to-day operations of the network operators. For example, the arguments for a more intrusive approach might give Ofgem comfort that the large DNO's and GDN's would not succumb to financial distress and indeed any additional costs associated with these additional measures would arguably be recovered through their price control mechanism. For independent operators these additional costs cannot be recovered and they would in turn make it even more difficult to source affordable finance to fund their licence obligations.

Question 4
As question 3 above.

5. *Impacts, Cost and Benefits*

Question 1
Energetics believe that the measures suggested in chapter 3 are disproportionate in relation to the perceived risks. Throughout this very difficult global recession all of the UK network operators, monopoly and independent alike, managed to navigate their respective businesses through the financial crisis. Whilst it would be wrong to suggest that the UK economy would not experience another recession as steep and as prolonged as this one, the fact that all of the network operators came through unscathed suggests that the current arrangements worked well.
Energetics would not advocate lessening the current requirements at this moment in time but would ask Ofgem to recognise that independent operators in particular need a period of stability while the UK economy embarks on a slow road to recovery.

Question 2
Energetics do not agree with this statement on the understanding that the proposed arrangements will introduce additional costs to independent operators that cannot be recovered. More importantly, with the proposed extension to the restriction on granting security over relevant assets, the cost of capital will increase for independent operators and securing debt finance will be extremely difficult. All of these issues will almost certainly result in independent operators being less able to compete on a level playing field with the monopoly operators.

Finally, may I take this opportunity to thank you for the opportunity to comment on this proposal and we look forward to receiving your views on the best way forward.

Yours sincerely

Mark Cummings
Director, Energetics Electricity & Energetics Gas