

OFGEM OPEN LETTER CONSULTATION ON THE DEVELOPMENT OF GAS AND ELECTRICITY INNOVATION STIMULI

Comments from Roger Barnard

- *The author is a barrister and was Head of Regulatory Law at EDF Energy until his retirement earlier this year. The comments below relate to issues raised by Ofgem's open consultation letter dated 12 October 2010.*

1. One of the themes of Ofgem's open letter is the need to encourage suitable qualified non-network parties to develop new and innovative ideas for network development. To that end, Ofgem proposes that a new class of gas and electricity licence – an innovation licence – is required so that third parties can receive funds under the stimulus mechanisms. The stated rationale for this proposal is twofold:

- (a) to enable holders of the proposed new licence to receive funding, and
- (b) to enable Ofgem to ensure that schemes are properly administered.

2. The proposal to create a new class of licence is actually a proposal that the Secretary of State, at Ofgem's instigation, should by order create a new licensable activity under sections 41C and 56A of the Gas Act 1986 and the Electricity Act 1989 respectively. However, it is not at all clear that this would be the simplest and most effective way to address Ofgem's policy objectives. In particular:

- (a) The provisions allowing government to designate a new licensable activity under the energy legislation are complex and untested, requiring what is likely to be a lengthy consultative process and ultimately involving, almost certainly, a time-consuming reference to the Competition Commission.
- (b) More importantly, it is questionable whether Ofgem's proposal would pass the statutory test for the creation of a new licensable activity. The legislation stipulates that activities may only become licensable if they are activities "connected with" (meaning, in this context, ancillary to) activities that are already within the scope of existing energy licences.

Thus, for example, it would be possible to make metering a new licensable activity because it is demonstrably "connected with" activities already regulated under network and/or supply licences. The same would be true of gas distribution as an activity "connected with" the already licensed activity of gas transportation.

It is doubtful, however, that innovation – i.e. merely the act of introducing something new – could properly be construed, within the strict meaning of the relevant statutory language, to be an activity "connected with" an existing licensed activity. It is not the legal intention of sections 41C and 56A to extend the scope of regulation to activities that have never been subject to controls through licences.

3. In fact, properly analysed, the activity that would actually be the authorised activity under the proposed new class of licence would be the activity of being a party to a particular kind of financial process, i.e. the otherwise unlawful activity of receiving from licensed network companies money raised from consumers via those companies' charges for use of system. Once it is stated in those terms, the essentially artificial nature of the proposal becomes clear.

4. This is not to deny the validity of Ofgem's concerns about the funding issue. For the effect of sections 7B(5)(b)(ii) and 7(3A)(b) of the Gas and Electricity Acts respectively is to restrict any movement of the revenues raised from network use of system charges to transfers between licence holders. However, the obvious solution to this problem is for Ofgem to persuade DECC to use the imminent Energy Security and Green Economy Bill as a vehicle to amend those subsections, so that payments can be made from licence holders to such non-licensed persons as may be determined by or under the appropriate licence conditions.

5. It is equally hard to see why other matters mentioned in Ofgem's open letter, such as third-party access rights and the need for Ofgem to be able to ensure that innovation schemes are properly administered, would justify the creation of a new licensable activity. These matters are all capable of being handled effectively under the kind of governance and compliance framework that has been established pursuant to the electricity distribution licence for the Low Carbon Networks Fund, and that will no doubt evolve and be adapted in the light of experience.

6. The author is happy for this paper to be published as a formal response to Ofgem's open letter consultation.

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