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1 July 2011

Dear Paul

**PROPOSED MODIFICATIONS TO THE 'RING FENCE' CONDITIONS IN NETWORK OPERATOR LICENCES – CONSULTATION AND IMPACT ASSESSMENT**

The views of CE Electric UK Funding Company (CE), Northern Electric Distribution Limited (NEDL) and Yorkshire Electricity Distribution plc (YEDL) on the Ofgem consultation *Proposed Modifications to 'Ring Fence' Conditions in Network Operator Licence* (the Consultation) are given below.

Broadly speaking we welcome the policy developments since the last Ofgem consultation on this subject but we believe that some improvements should still be made before the licence modifications are finalised.

We have participated in the group of distribution network operators (DNOs) on whose behalf comments were submitted to Ofgem on the drafting of the proposed conditions for electricity distributors. We commend these drafting proposals to Ofgem.

In this response we shall deal only with the remaining policy issues that are raised by the Consultation. Our answers to the specific questions raised by Ofgem are set out in the attachment to this letter.

***Composition of the board of directors***

NEDL and YEDL each have two independent non-executive directors, one of whose remit includes compliance with the regulatory regime (with special reference to the ring fence). We have no particular objection to the proposal that each licensee should be *required* to have two sufficiently independent directors, however we would like to see changes to the drafting so that the existing NEDL and YEDL independent directors would be eligible to serve in fulfilment of the obligations of the proposed condition without requiring special Ofgem consent. The drafting proposed by the DNOs would achieve this. The drafting suggested by Ofgem would mean that we would have to get special consent from the Authority.

**CE ELECTRIC UK FUNDING COMPANY**

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### ***Availability of resources***

We have no objections to the policy intent with respect to certification and intervention plans. We support the redrafting proposed by the DNOs, the purpose of which is to improve clarity and to differentiate clearly between the three matters covered by the certificates, namely financial resources, operational resources and licence compliance.

### ***Undertaking from ultimate controller***

We have no comments to make on the proposed policy with respect to reminding ultimate controllers of their undertakings on an annual basis.

### ***Indebtedness***

We have previously set out our reservations about the additional triggers for the cash lock up provisions. We do not think that it is sensible to apply the cash lock up where a licensee has signified that it has an operational resource deficiency. The cash lock up should apply only to financial deficiency. Indeed, an operational deficiency could be made more problematic if a group was prevented from using the resources of one licensee to remedy a resource deficiency in another (caused for example by localised industrial action in another licensee in the same group). We think a cash lock up in these circumstances would be counter-productive. The drafting suggested by the DNOs would remove this problem because the cash lock up would apply only to an adverse financial resource certificate.

Although we recognise the improvements made to the proposals to enhance the provisions that aim to ensure that cash remains in the licensee when the licensee may be on the verge of financial difficulties, for the reasons set out in our response to Ofgem's previous consultation we still believe that these restrictions are misconceived and may give rise to more problems than they will solve.

### ***Disposal of relevant assets***

We continue to believe that the proposal that the restriction on granting security/charges incorporated in the disposal of relevant assets licence condition should be extended to cover the licensee's receivables is unnecessarily restrictive.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John France', with a stylized flourish at the end.

**John France**  
**Regulation Director**

## Responses to questions set out in the Consultation

### CHAPTER: One

**Question 1:** Have we identified the risks and concerns which are important to you if you are:

- a network user (consumer, generator, shipper or supplier)?
- a finance provider, network owner or other stakeholder?
- a network operator?

1.1 Yes.

**Question 2:** Do you think that any of our proposals will require deferred start dates to allow NWOs to make preparations for compliance?

1.2 We suggest 1 April 2012 for the commencement date. That should give network operators time to make appropriate arrangements.

### CHAPTER: Three

**Question 1:** Do our proposed changes to the existing ring fence conditions effectively address the risks which we have identified in a proportionate way?

3.1 For the reasons set out in our covering letter and in our response to the previous Ofgem consultation we do not agree that the proposed changes are all proportionate to the risks identified.

**Question 2:** Have we satisfactorily addressed the responses to our initial consultation in terms of the impacts and alternatives which were raised?

3.2 Many of the concerns we raised have been addressed, but we continue to believe that the additional restrictions proposed are disproportionate or inappropriate. We believe that Ofgem has focussed too much on making the special administration regime (SAR) work and too little on preventing the circumstances from arising where the SAR would have to be applied.

**Question 3:** Do you think that our proposals will enhance the synergic working of the ring fence and the concept of a defence in breadth and depth against financial or operational distress?

- 3.3 The proposals may bring some benefits but for the reasons set out above we do not believe that Ofgem's proposals will secure defence in breadth and depth against financial or operational distress.

**Question 4:** Do you agree with the exceptions to applicability we have set out for certain types of NWO?

- 3.4 We have no comments to make on this.

**Question 5:** Have we drafted conditions which are clear and concise – or are there improvements that we could make?

- 3.5 In our joint work with other DNOs we have proposed material drafting improvements.

## **CHAPTER: Four**

**Question 1:** Do you think our revised proposal to require NWOs to have two sufficiently independent directors (SIDs) is proportionate and addresses the risks we have identified particularly in relation to possible conflicts of interest?

- 4.1 We do not particularly object to these proposals but we do not think that it is legally possible to achieve the purpose that Ofgem is seeking whilst recognising the duties of directors in law.

We propose changes to the drafting that would make it clearer and would enable our existing independent directors to fulfil the requirements of the condition without seeking special Ofgem consent.

**Question 2:** Does our revised proposal alleviate the concerns about legitimate influence and control by NWO owners raised in relation to our initial proposal to require a majority of independent directors?

- 4.2 Yes. We appreciate Ofgem's acceptance of the arguments we raised in response to the previous consultation.

**Question 3:** Do you have any comments on the alternative approaches which are referred to?

- 4.3 Whilst we are unpersuaded that it is necessary to require licensees to appoint two sufficiently independent directors, if that is to be the preferred policy because it is thought that this will insulate the licensee from the influence of an affiliate at times of financial stress, we cannot see how this purpose could be facilitated by allowing a non-executive director of a UK listed parent company to be regarded as sufficiently independent.

**Question 4:** Is our draft condition for sufficiently independent directors clear and concise, or could the drafting be improved?

- 4.4 In conjunction with other DNOs we have suggested significant drafting changes to the proposed condition on sufficiently independent directors.

**Question 5:** If a requirement for SIDs is introduced, how much lead time do you think should be allowed for candidates to be selected and appointed?

- 4.5 An effective date of 1 April 2012 should be achievable.

**Question 6:** Do you agree that the proposed condition for sufficiently independent directors should not apply to independent gas and electricity distribution network operators nor to offshore transmission operators?

- 4.6 There is a better case for relaxing the independence criteria within a given sector (i.e. being a director of one electricity distribution licensee should not preclude qualification as a sufficiently independent director of another electricity distribution licensee) than there is across sectors that happen to share the same regulator. We do not see the logic behind this.