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Dear David,

ESPUG Comment on Ofgem's "Informal consultation on proposed modifications to the Electricity Distribution Licence"

I am writing on behalf of ESP Utilities Group ("ESPUG") (comprising the licensed companies ES Pipelines Ltd, ESP Connections Ltd, ESP Networks Ltd, ESP Pipelines Ltd and ESP Electricity Ltd). We welcome the opportunity to respond to the "Informal consultation on proposed modifications to the Electricity Distribution Licence" ('the consultation'), dated 22nd January.

We welcome the decision to explore a number of potential changes to the electricity distribution licence to address concerns relating to allowing AIDNOs, in particular the objective to "ensure the licensee would manage and operate its Distribution Business in a way that would not restrict, prevent or distort competition in the distribution of electricity (as well as in supply, shipping and generation)." There are still however a number of legitimate concerns around AIDNO operating within the affiliated DNO Distribution Service Area (DSA). If these issues are not rectified, it presents a specific risk to competition in the connections market. This letter outlines our response to the proposals.

We believe that the original licence condition did not take into consideration the separation issues associated with firms working in the *same* industry sector. Historically it assumed that any separation would be between generation, networks and supply sectors. There are new areas that need to be addressed in this situation.

ESPUG breaks these areas down into three main areas where costs could be shared but not in our view adequately covered in the amended licence as they only need be *reported* in the compliance statement (42.7) i.e. sharing of premises, systems, equipment and services of persons. For AIDNOs specifically, this would be for sharing:

1. People resources; this includes sharing of engineering staff, pricing analysts, and specialist business support services such as regulations.
2. Information systems; MPAS, power flow modelling systems, IT.
3. Premises and rents

We encourage Ofgem to cover these areas in explicit business separation guidance for AIDNOs, and to ensure it has the power to request evidence and act to protect competition in the market when required,

There are more intangible aspects of the new AIDNOs that we think are also important, and again not anticipated in the current licence text Ofgem seek to amend. In particular:

- The power of the affiliated DNO brand.
- Referrals from the incumbent DNO.
- Cooperation in industry codes. Affiliate status need to be recognised in the code governance processes to avoid any conflict of interests.
- Cooperation in industry change programmes and reforms. The DNO could, in theory, help to make opportunities or markets more beneficial to the AIDNO, or use in-house knowledge of industry processes to gain advantage over non-AIDNOs.

We agree with the use of a compliance statement as a reporting tool but this needs to be accompanied by a strong monitoring regime with the same level of rigor we have in generation and supply.

Finally, on entry to the market, IDNOs face considerable start up and ongoing costs linked to regulatory requirements that are effectively sunk. A DNO has this capability already and an incentive to provide these support services to its AIDNO thus minimising these regulatory sunk costs. It is vital that the regulatory conditions do not disproportionately favor some market participants over another. We cannot see how if say in two years affiliates have a substantial market share due to their parent company that this is a good outcome of these licence changes for consumers.

If you wish to discuss any of the issues raised in our response or have any queries, please contact me on 01372 587500.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Seb Eyre', with a stylized flourish at the end.

Sebastian Eyre
Regulation Analyst

Do you agree that the proposed modifications would help mitigate the risks in relation to the grant of licences to AIDNOs that we have identified?

We do not agree that the changes will provide a fully robust framework to mitigate all the risks identified in the consultation and by respondents to it. However the proposals clearly seek to offer protections and are welcomed. Table 1 summarises our views on the degree of mitigation set against the risks identified in the December Update document.

Table 1

Risk identified in the Update	Degree of Mitigation
Information sharing and preferential treatment	Condition 4 is generally a good catch all condition. It may however, not deal with implicit unstated shared understandings between companies. We note that AIDNOs are run by the same overarching Board in the corporate structure even if they are separated.
Cost sharing and shared allocation of resources	Cross subsidy issue is adequately covered in 4.9 but enforcement may be difficult for <i>sharing</i> of common resources such as expertise, property or IT systems.
Benefits of the proposal to consumers	Consumers are unlikely to benefit from AIDNOs if they exploit holes in the regulatory regime. It could be the case that new non affiliates could be deterred from entry if the affiliated market share increases as a result of their advantages.
Wider issues	The licence is silent on the issues related to cooperation in industry codes and reforms.

Is there alternative wording that you consider would better achieve the intent of our proposals? If so, please provide details and rationale.

The proposed draft clearly aligns the business separation requirements for an AIDNO with supply and generation activities.

Condition 42.7 only restricts the sharing of confidential information between a DNO and an AIDNO. It does not appear to restrict the use of shared systems, people, buildings and other services. This only needs to be reported in the compliance statement. Sharing of building, people, systems and services is likely to provide the AIDNO with a cost advantage over other IDNO who operate in the market. Amending the wording of this condition 42 to prevent this, or to require any DNO to provide these services on an equal basis to any IDNO, would reduce this concern.

Current business separation rules do not appear to restrict a DNO from actively referring customer enquiries to their affiliate in their DSA over other IDNO. A specific restriction within the licence on this activity is needed to ensure that the competitive market is not distorted.

Do you consider that further modifications (in addition to those set out in this consultation) are required? If so, please describe these and provide rationale.

It would be helpful for Ofgem to publish regulatory guidance for DNOs specifically in relation to AIDNO business separation and to clearly set out those areas of activity where there should be clear separation of businesses. Further to this, we believe the guidance should set out examples of the evidence Ofgem expects to see to support the AIDNO compliance statement. Table 2 identifies some monitoring information we expect to be reported on in the compliance report.

Table 2 Information requirement for compliance report

Information	Rationale
• Anonymised employee records	Identify shared staff (e.g. regulatory teams, HR, finance, design engineers)
• Shared property portfolio	To ensure a high degree of physical separation
• IT and shared services manifest	List all shared IT resources especially design
• Referrals to subsidiary and brand separation	This is a benefit of the power of the brand

We also believe a robust monitoring program is critical, and we are concerned that this is missing from the consultation. Ofgem must ensure it has powers in place to act should any issues materialise. We would like this set out in the guidance document. We also suggest an audit on start-up and annually after that.

Finally, it would be useful for Ofgem to review the regime after three of years of operation.