

**Date: 6<sup>th</sup> March 2019**

**Consultation: Affiliate IDNO informal consultation on proposed modifications to the Electricity Distribution Licence**

**General Comments:**

We appreciate Ofgem recognising the concerns we raised in our responses to the initial consultations on this issue. We recognise the intent within the proposals to mitigate the risks that affiliate independent distribution network operators (AIDNO) will present to the market. We are not opposed to additional competition in the IDNO and new connections markets but we are concerned that these proposals will still provide AIDNO with an unfair advantage and that they do not go far enough.

We are disappointed to see that Ofgem haven't considered restricting the ability of an AIDNO to operate within the affiliate DNO Distribution Service Area (DSA). We continue to believe that this presents a specific risk to the market.

The Ofgem proposals for full business separation between AIDNO and DNO are a reasonable approach to mitigate the risks to competition from a regulatory perspective. However we do not believe the proposed amendments to the distribution licence go far enough in mitigating the potential risks that AIDNO will present.

Key to Ofgem's proposals are amendments to SLC 42.5 to ensure that operational and management separation of an AIDNO from a DNO occurs and this is something that we support.

These proposals do not envisage any change to SLC 42.7. As a consequence a DNO and its AIDNO would be able to share IT systems and buildings. Although the obligation restricts the sharing of data between the two organisations it does not prevent the costs for these services from being shared. This would provide the AIDNO with a clear cost advantage over independent IDNO operating within the market – particularly if the AIDNO is only charged a marginal cost for the provision of services or buildings.

In the December 2018 consultation Ofgem expressed concerns regarding the impact on the connections market of an AIDNO/DNO arrangement, in particular within their DSA. This is a concern that we also share and we are disappointed that this risk has not been addressed by the proposals.

In particular there would appear to be no restriction on a DNO explicitly promoting their AIDNO in the connections market. Nor is there any safeguard regarding a DNO retreating from providing services in their DSA and instead referencing customers to their AIDNO.

We see the situation with DNO as being similar to that of Openreach in the telecoms sector and suggest that Ofgem consider the approach used in this market to ensure that they do not distort competition.

If Ofgem's intention is to continue with the approach of using licence enforced business separation our preference would be to see specific amendments be made to SLC 42 regarding the distribution of electricity. These should include:

- Restrictions regarding the operation of an AIDNO in a DNO's DSA
- Prohibition on the promotion of an AIDNO by the DNO (or other affiliate DNOs)
- A ban on the sharing of common services; including buildings, IT systems and key engineering staff.

If however, Ofgem are keen to keep the amendments to the overall licence wording minimal, then an approach of providing accompanying regulatory guidance to SLC 42.5 should be applied. The regulatory guidance would set out in detail how business separation should be applied regarding the distribution of electricity.

This guidance would be binding upon the DNO, be enforceable by Ofgem and could be amended over time as situations and circumstances change.

The regulatory guidance would set out how separation of shared services should be undertaken by a DNO. It should:

- include specific reference to separation of any shared services that might provide an AIDNO with an unfair advantage. It should include examples such as the support for the provision of MPAS systems, engineering staff and regulatory personnel involved with the development of network charging methodologies and statements.
- restrict the DNO from providing any services to an AIDNO that they would not also provide on an equal basis to any other IDNO (e.g. use of shared building facilities). This would help ensure that the AIDNO is not provided with an advantage over any other IDNO operating in the market.
- Be clear that Ofgem would seek additional reassurance in the DNO compliance statement regarding services they undertake and provide to any AIDNO in their DSA.

We suggest that compliance monitoring of DNOs and their AIDNO licensees initially should be to a rigorous and in depth nature. This will permit greater understanding of potential business models by Ofgem and the risks that these may present to the market. It will also send an appropriate signal to DNOs that this is an area where there will be significant regulatory scrutiny.

Considering the potential threat we urge that Ofgem carry out a review of the impact on the market 3-5 years after the award of any AIDNO licence to understand the negative impact that it may have made.

## **Responses to Consultation Questions:**

### ***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 recognise that Ofgem have understood the concerns raised and attempted to implement a set of proportionate and yet effective measures to mitigate the risks.

We believe that it would be better to include a reference within SLC 42.5, excluding a DNO from operating an AIDNO within their DSA.

Compliance with full business separation will be vital to ensure that an AIDNO does not have an unfair advantage over other IDNO operating in the market. Thorough monitoring and enforcement will be required by Ofgem with appropriate resource dedicated to this activity.

### ***Is there alternative wording that you consider would better achieve the intent of our proposals?***

The proposed wording is clear, it aligns the business separation requirements for an AIDNO with those for supply and generation activities.

However SLC 42.7 only restricts the sharing of information between a DNO and an AIDNO. It does not restrict the use of shared systems and buildings and other services. This will provide the AIDNO with a cost advantage over other IDNO who operate in the market.

Amending the wording of this SLC to restrict this, or to require any DNO to provide these services on an equal basis to any IDNO, would help mitigate this potential risk.

It would be helpful for Ofgem to publish regulatory guidance for DNOs in relation to AIDNO business separation and to set out clearly those areas of activity where there should be clear separation of functions.

In particular this should include reference to areas of activity that a DNO undertakes that would be beneficial to an AIDNO, such as engineering activities and the provision of DNO specific IT systems (e.g. MPAS and billing systems) and services.

### ***Do you consider that further modifications (in addition to those set out in this consultation) are required?***

We still believe that specific risks exist for an AIDNO operating in the DSA of a DNO and that it would be preferable to exclude them from operating in these geographic areas. We are not sure how an AIDNO would effectively compete with its affiliate DNO host, and therefore what benefits allowing such arrangements would bring to customers.

There are no restrictions within the current business separation rules that would appear to restrict a DNO from actively promoting their AIDNO 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.