

Electricity distribution licensees  
and interested parties

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Dear colleague,

### **Update on our consultation on electricity distribution licence applications from affiliates of existing licensees**

On 24<sup>th</sup> July 2018, we<sup>1</sup> consulted on the potential of an affiliate of an existing licensee to apply for and hold an electricity distribution licence ('**the proposal**')<sup>2</sup>. That is, an affiliate of a Distribution Network Operator ('**DNO**'), applying for a licence to operate as an Independent Distribution Network Operator ('**IDNO**'). We invited views on the potential implications of such a case, which we referred to as an affiliated Independent Distribution Network Operator ('**AIDNO**'). We also asked, if we were to grant such a licence, whether additional measures would be required to protect the interests of consumers.

Having carefully considered responses to our consultation and further assessing the proposal, this letter sets out our updated views. Having considered the potential effects of granting licences of this type, our view is that it could further increase competition in connections. However, there is also a significant risk that (in the absence of appropriate protective measures) competition could be distorted through the actions or behaviour of the relevant DNO. For example, by giving some undue preference to its affiliated IDNO and or sharing of commercially sensitive information that is not disclosed to other market participants.

We consider, therefore, that some modifications are likely to be required to the electricity distribution licence to mitigate the potential risks. These modifications would be designed to give us the necessary tools to protect consumers' interests. We believe these changes should be in place before we grant any such applications and we plan to consult on these changes in early 2019.

We will also examine in more detail some of the wider issues raised in responses to our initial consultation. These are not unique to the issue of AIDNOs and we plan a period of information gathering to better understand these points.

### **Background**

DNOs are licensed by us to distribute electricity from the high voltage transmission grid to industrial, commercial and domestic users across Great Britain (GB).

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<sup>1</sup> The terms "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/independent-distribution-network-operators-licence-applications-affiliates-existing-licensees>

Some types of work associated with obtaining a new connection can be provided by other parties (known as 'contestable work'). DNOs may carry out contestable works, but it is also open to IDNOs and Independent Connection Providers (ICPs) to compete for the work.

IDNOs were introduced to open the electricity connections market to competition, ultimately with the aim to improve the quality of service received by connection consumers, reducing the cost of connections and encouraging the development of innovative connection services.<sup>3</sup> They tend to own and operate smaller networks – typically, but not limited to, new housing and commercial developments. IDNOs are licensed to operate across GB and connect to the distribution network belonging to the DNO in whichever area of the country they are operating (the 'host DNO'). In doing so, the IDNO provides, and is responsible for the ongoing ownership and operation of, the final part of the network to the end user. Like DNOs, IDNOs are licensed by us but a number of licence conditions are not in effect, or have been modified, for these networks.

ICPs can act on behalf of clients to carry out contestable works but they do not retain the network they build. DNOs and IDNOs compete for the long-term ownership and operation of the network upon completion by the ICP. We do not license ICPs but they are accredited under the National Electricity Registration Scheme operated by Lloyd's Register.<sup>4</sup>

### **Summary of responses to our consultation**

We received 14 responses from DNOs, IDNOs and other interested stakeholders. A more detailed summary of the responses received and our updated views are found in the annex to this letter. We have published the non-confidential responses on our website.

A summary of the key themes raised in the responses is detailed below.

#### Information sharing and preferential treatment:

- Those against the proposal warned of a DNO's potential ability to provide information to their AIDNO – such as information in relation to system constraints and interactive competitive quotes - while excluding (or delaying the provision of such information to) non-affiliated IDNOs.<sup>5</sup> This situation would (in their view) provide AIDNOs with an undue competitive advantage against other IDNOs.
- Respondents against the proposal also highlighted the positive discrimination AIDNOs could benefit from through publicity campaigns, or 'lead referrals', by the DNO leading customers to choose AIDNOs over competitors.
- Respondents in favour of the proposal argued that similar information sharing concerns were already addressed by the existing protections in the electricity distribution licence and competition law, which provides for sanctions should there be a breach. They considered that this ultimately acts as a deterrent to any kind of activity that would see a DNO acting in breach of those obligations.
- Some respondents pointed to existing licence conditions and competition law as sufficient to address concerns, whilst others felt that current protections were insufficient and further measures were needed.

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<sup>3</sup> For the avoidance of doubt, any reference to market within this letter is not intended to set out conclusively our position on the relevant market for the purposes of a Chapter II / Article 102 investigation.

<sup>4</sup> <https://www.lr.org/en/utilities/national-electricity-registration-scheme-ners/>

<sup>5</sup> Competitive interactive queues arise as a result of Interactive Connection Applications. This usually occurs where a Network Operator receives two or more applications for connection, which make use of the same part of the Existing Network. Interactive Connection Offers are made in respect to this, and the Interactive Queue is a queue of those in receipt of such offers.

- One respondent argued that AIDNOs will not be unduly favoured as, just like other non-affiliated IDNOs, their business model would be based on services being procured from external contractors and not the affiliated DNO.

#### Cost sharing and shared allocation of resources:

- Comments against the proposal highlighted a number of ways in which AIDNOs could financially benefit from their relationship with DNOs. This could include avoiding certain start up and ongoing costs in order to comply with their regulatory obligations (for example, through shared 'back office' functions).
- Even if the affiliate DNO were to charge the AIDNO for the provision of such services, concerned respondents considered the AIDNO will have an undue competitive advantage over existing IDNOs, particularly if the amount it pays for such services is less than the efficient sunk costs that stand-alone IDNOs have had to incur. Such savings would, in turn, enable AIDNOs to offer more attractive deals to customers, thus placing non-affiliated IDNOs at a disadvantage.
- These concerns were not expressed by all respondents. One respondent in favour of the proposals argued that these concerns were not only already addressed by current legislation, but that such activities would be identifiable through the DNO's annual regulatory returns, and the annual accounts of the IDNO.

#### Benefits of the proposal to consumers

- Respondents in favour of the proposal believed that the main benefit would be increased competition. Customers, it was argued, would have more choice when it comes to choosing a distribution operator to own and operate their networks. Respondents with concerns about the proposal did not believe that competition would be enhanced for the reasons outlined above, so did not see it bringing benefit to consumers.
- Additionally, one respondent in favour of the proposal stated AIDNOs would be able to provide 'tariff support' adoption payments, which DNOs are currently unable to do. They state this would lead to increased competition for certain types of network assets to the benefit of consumers.
- Respondents who supported the proposal also argued that another benefit to licensing AIDNOs is the potential to use this as an opportunity to provide more innovative solutions to customers when compared to the incumbent DNOs.

#### *Wider issues*

A number of respondents also raised issues with the wider regulation of IDNOs. These included:

- A more onerous regulatory regime for DNOs compared to IDNOs because of different treatment in the distribution licence and price control framework.
- The ability of IDNOs under the Relative Price Control to win new networks by offering an asset value to connecting customers (or ICPs) which reflects the forecast long-term revenue from Distribution Use of System (DUoS) charges and offsets the upfront connection charge. Respondents highlighted that DNOs are unable to do this.

We have considered all of these issues in the context of reaching the decision set out in this letter. We consider that, if appropriate licence modifications are implemented, this will be a significant step towards addressing the concerns we have identified around the emergence of AIDNOs.

We note however that a number of the views expressed by respondents go further than the scope of this decision, and are not specifically tied to AIDNOs entering the market. We want to explore these in more depth and set out our proposed next steps to address these below.

Some respondents also flagged the risk to IDNOs of not being fully considered when assessing charging reforms – and an AIDNO might have an advantage over IDNOs if it was able to exert influence through its affiliated DNO. Our view is that when seeking to prevent sharing of information and preferential treatment (including using an affiliate relationship to attempt to exert influence), this should work in both directions, not just from the DNO to AIDNO. While we think the issue of IDNO representation is wider than the scope of this letter, we agree that there are a number of changes currently being assessed which could impact IDNOs. We recently published our minded to position and impact assessment on the Targeted Charging Review (TCR).<sup>6</sup> We have also set out the scope for our work on electricity network access reform and forward looking charges.<sup>7</sup> These have the potential to significantly change the way the costs associated with operating and maintaining distribution networks are recovered in the future. We encourage all parties to engage fully with these reforms. We will consider the impact of these changes on IDNOs as part of the next steps set out below.

### **Our updated position with regard to AIDNOs**

We set out in our consultation that the emergence of IDNOs has benefitted consumers through increased competition in connections. We also identified some potential unintended consequences of granting a licence to affiliates of existing licensees.

We continue to believe that allowing new entrants to enter the market should benefit consumers through lower prices and improved service. However, in order to achieve this, we consider that the relevant parties must not have the opportunity to use their position within the market to negatively affect competition as this will ultimately affect the interests of consumers.

Some respondents pointed to existing licence conditions and competition law as sufficient to protect competition. We disagree for a number of reasons. The licence conditions which seek to avoid distortions of competition (as currently drafted) do not always capture competition in *distribution* (or at least, those aspects where competition exists) and so do not offer the level of protection that has been argued by respondents, and exists in relation to the conduct of other licensed activities. We have not seen any evidence that suggests this was a deliberate omission (or restriction in the scope of the licence protection). Rather, we believe that the market has evolved and it may now be an appropriate time to consider the scope of the provisions which capture competition in distribution activities.

### **Next steps**

#### *Licence changes to address concerns on allowing AIDNOs*

We plan to explore a number of potential changes to the electricity distribution licence to address concerns relating to allowing AIDNOs. Our thinking on what specific changes may be required is still under consideration. Examples of the licence conditions which we may seek to modify include (though is not necessarily limited to):

- SLC4: No abuse of the licensee’s special position; and
- SLC42: Independence of the Distribution Business and restricted use of Confidential Information

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<sup>6</sup> <https://www.ofgem.gov.uk/electricity/transmission-networks/charging/targeted-charging-review-significant-code-review>

<sup>7</sup> <https://www.ofgem.gov.uk/electricity/transmission-networks/charging/reform-network-access-and-forward-looking-charges>

Once we have completed our assessment as to which licence modifications we consider to be appropriate, we will publish a consultation on proposed licence drafting in early 2019.

The consultation will provide interested parties with the opportunity to provide representations on our proposals and these will be taken into account when reaching our decision as regards licence modifications.

We consider that such changes, if duly implemented (following the relevant statutory consultation), would provide a more effective regulatory framework for the distribution sector and be a better basis from which we could determine licence applications from prospective AIDNOs.

The changes we seek will also give us the tools to monitor the market and take action where necessary.

### *Wider Issues*

We intend to explore the wider issues raised by respondents.

In the first instance, we will make an information request to the relevant parties to allow us to better understand the issues and fill gaps in our understanding where they exist. We will also consider the impact of TCR and access reforms on IDNOs.

We may then hold a short series of workshops with relevant stakeholders in Spring 2019 to discuss these issues. We will also explore whether there are benefits from working with, or learning lessons from, other regulated sectors such as water or telecoms. This may lead to further changes in how we regulate independent networks in the future.

If you have any questions in relation to this letter please contact David McCrone at [david.mccrone@ofgem.gov.uk](mailto:david.mccrone@ofgem.gov.uk) or 0141 354 5441. While we are not formally requesting responses to this letter, we will take any submissions into consideration for our future work.

Yours faithfully,

**Eleanor Warburton**  
**Deputy Director, Gas, Heat and Emerging Issues**

## **Annex: responses to our consultation and our views**

This section summarises the responses to the specific questions in our consultation. We set out our updated view following each question.

### **What are your views on the potential impacts on competition in connections and or consumers that we have identified?**

Some respondents highlighted the benefits to consumers which IDNOs have made since their introduction. They believed granting a licence to an affiliate of an existing licensee builds on this because new players are introduced, leading to more competition. However, some considered that this will only be true if the AIDNO operates on the same level playing field as other IDNOs.

Respondents in favour of allowing affiliates of existing licensees believed that the existing provisions in the electricity distribution licence, and wider competition law, were sufficient to mitigate any risks to competition or consumers. In their view, this would provide a substantial deterrent to any kind of activity that would see a DNO acting in breach of its existing obligations or trying to leverage any advantage for its affiliate.

One further respondent believed that issuing a distribution licence to an affiliate of an existing licensee could contribute to a greater level of competition in connections giving customers a wider choice in the market place. However, to ensure that competition is fair and beneficial to consumers there should be equal obligations on IDNOs and DNOs. To address this Ofgem should remove any differences in the licence conditions being applied to IDNOs and DNOs and should act to prevent IDNOs from being able to reduce the capital cost of a connection by recovering a proportion of the connection charge through the ongoing use of system charges.

A number of responses against the proposal highlighted the potential for the AIDNO to receive preferential treatment compared to other IDNOs. Respondents said this could be achieved by the DNO promoting the AIDNO to undertake contestable connections work over the DNO or other IDNOs.

Some respondents also stated that an AIDNO could also have access to information on constraints, interactive quotes and charging models that other IDNOs would not have. A further respondent against the proposal also indicated previous DNO behaviours and actions warranted robust and appropriate arrangements but did not provide further details.

#### *Our views*

We agree that effective competition should bring benefits to consumers through lower prices and better service. A genuinely independent AIDNO could, therefore, provide more choice to consumers and exert competitive pressure on DNOs and IDNOs. However, we remain of the view that there are risks.

A DNO's action, or deliberate inaction, could skew the market in favour of its AIDNO. We consider AIDNOs could also gain an undue competitive advantage if they are able to access information (via the DNO) that is not yet available to its competitors. This could be via shared systems or resources, through informal workplace conversations, or by offering services exclusively (or on preferential terms) to their AIDNO. If the DNO is able to share information with the AIDNO that allows it to avoid loss making or low margin connections then this could place other IDNOs at a competitive disadvantage and potentially, in the long term, make it less attractive to remain in the market therefore reducing choice for consumers.

We disagree with respondents that believe existing licence conditions are sufficient to mitigate these concerns. Some responses quoted SLC4.1 whereby the licensee must operate its distribution business in a way that it does not restrict, prevent or distort

competition in the supply of electricity/gas, shipping or generation of electricity. The scope of this provision, however, does not cover distribution. Our current thinking is that this is because competition in distribution (and its associated activities where competition exists) was not widely anticipated when the licence condition was first drafted, rather than by design.

Some respondents pointed to SLC 31B.2 (amongst others) which states the licensee must put in place and at all times maintain managerial and operational systems that prevent any Relevant Licence Holder from having access to Confidential Information. There is, however, no mention of 'distributor' in this SLC and the definition of a Relevant Licence Holder does not include a distribution licensee. We can foresee circumstances where some sharing of information may be appropriate between network companies in the future. However, the current regulatory framework (including the distribution licence and relevant competition law), may not provide sufficient protection as regards to distortion of competition in distribution where competition exists.

Effective competition requires a level playing field between IDNOs (affiliated and non-affiliated). While we see no reason to prohibit affiliates of existing licensees from applying for a licence, we consider that changes to the electricity distribution licence may be necessary to reflect this development. This should balance enabling the emergence of new entrants and business models while giving us the necessary tools to protect consumers.

### **Are you aware of any other potential impacts on competition?**

Some respondents against the proposal reiterated the points previously raised in the first question. They also added that the risk of discrimination against non-affiliate IDNOs could potentially become apparent in the form of; contractual terms and conditions, enforcement of the contract, prioritisation of works and an unfair advantage in access to information regarding the DNO's network. One respondent also claimed that AIDNOs could rely on the DNO or company group's credit rating when providing credit cover.

Another respondent argued that to avoid any potential impact in the long term, we would need to ensure that IDNOs comply with the same number of performance and reporting obligations as DNOs. As such, an equal level playing field will be maintained and, consumers connected to the IDNO network would have the same level of protection as those connected to a DNO network.

One respondent in favour of the proposal argued that the connection market would not be impacted, whether a licence is granted to an affiliate of a DNO or not since an IDNO licence is not necessary to enter it. Affiliates of DNOs are already free to compete in this market as ICPs and many already do so. Moreover, the respondent also claimed that competition for certain types of network assets will actually increase thanks to this proposal.

One respondent explained that a precedent for this proposal had already been established within the gas sector as the GDN, National Grid Distribution, was granted an IGT licence for, what used to be, its affiliate business Fulcrum Pipelines Ltd. Given the similar models of competition in connections in gas and electricity distribution, they expected that affiliates to DNOs should also be granted a licence.

One respondent stated that we should conduct a review of the connections markets given the growing importance of Distribution System Operators (DSO).

### *Our views*

As stated above, we agree that effective competition should result in benefits for consumers through lower prices and better services. However, some risks exist that we consider should be mitigated.

We discussed our views regarding access to confidential information, preferential treatment and having sufficient safeguards in place in our response to the first question, so will not reiterate them here.

With regards to leveraging the wider company group to obtain a sufficient credit rating, Amended SLC BA3 states that the licensee takes all appropriate steps to have in place an investment grade credit rating provided by credit rating agencies listed in the licence. The licence does not set out how this should or should not be achieved.

We agree with the observation that an affiliate of a DNO may already establish itself as an ICP and compete for new connections work. However, an ICP must hand over a newly completed network to a DNO or IDNO to own and operate it on an enduring basis. The adopting party is then able to benefit from the future DUoS revenue earned from that customer. The AIDNO in this case would be competing with the relevant DNO and other IDNOs for the long-term ownership of the network and this should be done on an equal basis.

We have noted the comments about affiliate IGTs. The current gas transporter licence already considers "competition in the transportation of gas conveyed through pipes" which may be analogous to electricity distribution. The protections which we think may be necessary in the case of AIDNOs may therefore already exist in gas. We will further consider the arrangements in gas and identify any lessons when looking at proposed changes to the electricity distribution licence.

Our views set out here are relevant to the potential for affiliates of electricity distribution licensees to obtain licences. Responses to the wider issues such as differences within the licence are not discussed in this section. We set out in the cover letter how we propose to take these forward separately.

**Do these change whether the IDNO is operating in or outside of the affiliated DNO's DSA(s)? If so, how?**

Some respondents were against allowing AIDNOs to compete within a DNOs' DSA. One of these respondents also explained that given the high market share a DNO possesses in its own DSA, and the low product differentiation, DNOs might promote the AIDNO to complete contestable work over their own business. DNOs might also merge their services with their AIDNO operating in their DSAs – "self-cannibalisation" of services. This could potentially undermine existing incentives for the DNOs to engage with customers, such as Incentives on Connection Engagement (ICE). In order to prevent this from happening, certain respondents suggested that, at a minimum, AIDNOs should be prohibited from operating within their DNOs' DSA.

One respondent in favour of the proposal explained that concerns expressed over AIDNOs were also relevant to non-affiliate IDNOs. Therefore, imposing restrictions specific to AIDNOs would provide non-affiliate IDNOs with a competitive advantage.

Some respondents also argued that these concerns raised are already being addressed by current regulation. For example, the SLC 52 and the Competition in Connections Code of Practice (CiCCoP) allows for an environment of increased transparency, in terms of data and policies, in which DNOs have to support competition and where ICPs and IDNOs have access to DNOs network information. One respondent highlighted that any issue raised against this proposal would more likely be one of perception than of reality. In fact, it was claimed that not granting a licence to AIDNOs would actually weaken competition since a lesser number of companies would compete for clients. As such, it was argued by some respondents that operating in an affiliate DNO's DSA would be the same as working outside of it.

Nevertheless, some respondents warned that, given the emergence of DSOs, Ofgem should undertake a review of the operation of the connections market to ensure an equal and level playing field is maintained between IDNOs and DNOs. One respondent also underlined the

necessity to make the DNO specific licence obligations also applicable to IDNOs as these current differences create unequal market conditions.

#### *Our views*

If AIDNOs were used to undermine existing incentives such as the ICE this would be of concern due to the impact on quality of engagement and services experienced by customers. We will keep this issue under consideration. We consider the risks associated with this could be mitigated if for example, we modify SLC 4 of the electricity distribution licence to ensure that DNOs do not exclusively promote AIDNOs within their area. This would prohibit AIDNOs from gaining an unfair advantage through the DNOs, which in turn would seek to prevent DNOs from avoiding their obligations under the ICE.

We agree with comments made to highlight the obligations on DNOs to support competition, through SLC 52 and the CiCCoP. However, we disagree with comments stating that working within an affiliate DNO's DSA is the same as working outside of it. Working within the DSA of an affiliate could provide opportunities to share information not available to other IDNOs. As stated previously, we are considering amendments to the standard conditions of the distribution licence to address these risks. In doing so, we may seek to prevent the sharing of information with the AIDNO that is not otherwise available and subsequent distortion of competition when an AIDNO works within its affiliate DNO's DSA.

As we set out in our views above, the alignment of regulation between DNOs and IDNOs is outside the scope of this decision but is touched on separately under 'next steps' in the cover letter.

#### **Do you agree with our conclusion that granting a licence to an affiliate of an existing licensee does not raise any new issues with DUoS charges?**

One respondent agreed because, under the Relative Price Control (RPC), IDNOs have always had the option to charge domestic customers less than the host DNO.

However, one respondent disagreed explaining that an IDNO mirroring the RPC of an affiliate DNO could have greater access to information in DNO charging models and use that information to unduly influence the development of charging methodologies. They also considered there is an opportunity of double recovery of the costs of providing services, once by the affiliate DNO through its price control and then again by the IDNO through the RPC mechanism. In order to mitigate such a risk, complete business separation would need to take place.

One respondent claimed to broadly agree but explained that if an AIDNO gained a significant market share within a DSA, it might be possible to "tilt" charges to different classes of customer within the methodology to the IDNOs or DNOs advantage. Another point of concern was raised with regards to the Relative Price Control (RPC) not serving its purpose of protecting the interests of energy consumers.

#### *Our views*

We note the concerns raised by respondents against the proposal on AIDNOs potentially gaining greater visibility of DNO charging models, and the potential of a double recovery of costs. Regarding greater access to information, we will consider where it is appropriate to amend the licence to ensure distribution is accounted for in SLCs that prevent the sharing of confidential information.

RPC ensures that customers of IDNOs are not charged more than they would have been if they were connected to a DNOs' network. We do not consider that allowing AIDNOs to apply for a licence creates any new issues with RPC but we have set out our views above on wider issues raised in responses.

Based on our current thinking, we agree that an appropriate degree of business separation should be in place, and ring-fencing restrictions are already provided for within the licence. In addition to the restrictions within the licence, we could further monitor AIDNOs to ensure compliance. If evidenced through our monitoring that there is a need for additional information, then we may seek to place additional reporting requirements on the relevant parties.

**What other impacts on existing consumers, if any, do you anticipate from granting such a licence?**

Some respondents against the proposal stated that additional costs would be borne by consumers due to cross-subsidies between affiliated businesses. Additionally, one respondent also highlighted that existing consumers would be impacted by reduced customer choice due to the market stalling, IDNOs not having access to the technical standards used by DNOs, and high additional assessment and design fees that would be recovered by the group. The respondent also noted there would be single source procurement standards; DNO customers subsidising new connections operated by AIDNOs and changes to the cost of capital due to the perception of higher regulatory risk.

Some respondents in favour of the proposal stated that some customers would benefit through more choice in operators and more competition.

Other comments made were not on impacts but rather precautionary comments on what needs to be done to protect consumers. A couple of respondents highlighted that the end consumer does not benefit from the protections gained under the RIIO framework due to inconsistencies between DNOs and IDNOs and as to prevent this, consumers must receive the same level of protections as DNO customers in their DSA. Additionally, one respondent stated if there are asset transfers between DNOs and AIDNOs, the original protections from the licence should remain.

*Our views*

On the first point of cross-subsidy, our view is that the current licence (for example, SLC4.9) has requirements in place to avoid this. We will consider the extent to which licence modifications may be required to further address these concerns.

We agree with some respondents who supported the proposal that there will be more choice for those requiring connections. However, we do not consider that simply increasing the number of parties active in the market will automatically improve competition. Without further examining the changes we think are necessary, there is a risk of AIDNOs gaining an unfair advantage which could distort competition.

With regards to having safeguards in place, we agree that this needs to be in place and as stated above, we consider that amending the licence may therefore be necessary to ensure customers are protected by preventing the potential for AIDNOs and DNOs from sharing information and potentially distorting competition.

We acknowledge that there is a difference in the level of obligations that apply to IDNOs compared to DNOs. This will be considered as part of our future work.

**Do you think that the current IDNO licence conditions are sufficient to address the concerns raised in this letter? What additional measures do you think would be required?**

Some respondents believed that the current licence is sufficient to address the concerns raised in the consultation. They also stated the CiCCoP and the Competition Act 1998 provide for additional protections and further regulation and measures are not required. They argued that more stringent regulation on different parties could distort competition between DNOs, IDNOs and AIDNOs.

Other respondents stated the licence should be drafted to exclude AIDNOs from operating within its group DNOs DSA, whilst also strengthening section B of the licence to ensure full separation between DNOs and AIDNOs.

A further respondent stated additional reporting or compliance measures may be appropriate initially which could be removed once industry and Ofgem are confident of the impact on the market.

Some respondents highlighted the need to change how we regulate IDNOs more widely; they stated that this should be through a significant review on the connections market to ensure a level playing field and through evolving regulation that creates a level playing field for all participants. One respondent also stated that, to create a level playing field, the option for IDNOs to offset connection charges against future revenue should be removed.

#### *Our views*

As set out above, our current thinking is that the current licence conditions may not provide sufficient protection. We consider it necessary to examine whether specific SLCs should be modified to ensure they incorporate distribution activities (where competition exists), thus preventing the potential for sharing commercially sensitive information and ensuring competition. Regarding a wider review of IDNO regulation, we have set out our views earlier in this letter.

#### **Do you think prohibiting an IDNO from operating within specified areas (for example the affiliated DNO's DSA(s)) would sufficiently address the concerns we have raised?**

Some respondents supported allowing AIDNOs to operate across GB, and were keen to avoid different regulatory arrangements for different parties. One respondent with no concerns with the AIDNO working out of area, also said restrictions against named sites should not be allowed.

One respondent noted restrictions are not required as long as there are sufficient ring-fencing arrangements in place. However, they noted we need to review existing safeguards to ensure they apply to AIDNOs.

A few respondents strongly believed that AIDNOs should not be licensed to operate with their group DNOs DSA due to the risk of undermining arrangements such as incentives that only apply to DNOs. Others noted that restrictions are only a part of the solution, but there are concerns nationally with the licencing of AIDNOs and full separation between AIDNOs and DNOs should be undertaken.

A couple of respondents stated if a level playing field between different operators existed, then it would be acceptable to have geographic restrictions. One of the respondents also stated if the DNO licence conditions were aligned with the obligations on IDNOs, the AIDNO would not be able to offer any competitive advantage within the DSA and would have no commercial incentive to compete with the DNOs.

A respondent noted that AIDNOs working with its group DNO's DSA could result in some complex policy issues and material concerns for customers. However, these concerns are lessened due to SLC 52 and CiCCoP.

#### *Our View*

We do not think it is appropriate to restrict AIDNOs from operating within their affiliated DNO's DSA, as long as protections are in place. Any amendments to the electricity distribution licence which we propose should prevent the sharing of confidential information that advantages AIDNOs inside or out of the DNO's DSA. Additionally, it should ensure distributors act in ways as to not distort or prevent competition.