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All electricity distribution
licensees and other interested
parties

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Date: 13 February 2019

Dear Colleague,

Informal consultation on proposed modifications to the Electricity Distribution Licence

Overview

This letter invites views on proposed modifications to the Standard Licence Conditions (SLCs) of the electricity distribution licence. This follows the publication of our updated position on electricity distribution licence applications from affiliates of existing licensees on 20 December 2018.¹

The purpose of these proposed modifications is to ensure that the distribution licence continues to be 'fit for purpose' if an affiliate of an existing distribution licensee is successful in applying for and holding an electricity distribution licence (an 'AIDNO'). The proposed modifications seek to ensure that the licence conditions better protect consumers' interests.

The proposed changes apply to Sections A and B of the licence. The proposed modification in Section A (SLC 4) applies to all electricity distributors, namely Distribution Network Operators (DNOs) and Independent Distribution Network Operators (IDNOs). The proposed modification in Section B (SLC 42) applies only to electricity distributors who are Distribution Services Providers. That is, DNOs acting within a Distribution Services Area (DSA).

Background

We published our 'Update on our consultation on electricity distribution licence applications from affiliates of existing licensees' on 20 December 2018. The update set out our views on stakeholder responses to the 'Independent Distribution Network Operators – licence applications from affiliates of existing licensees' consultation published on 24 July 2018, as well as the potential effects of granting an AIDNO licence.²

We considered that the granting of distribution licences to AIDNOs could result in some benefits for consumers such as increased competition in the distribution sector, but that clear and appropriate protective measures were necessary to ensure that such competition was effective. Following the assessment of responses from the initial consultation and

¹ [Update on our consultation on electricity distribution licence applications from affiliates of existing licensees](#)

² [Independent Distribution Network Operators – licence applications from affiliates of existing licensees](#)

exploring the potential impacts of granting an AIDNO licence, we confirmed in our update in December that we would consult on proposed modifications to the electricity distribution licence.

Rationale for proposed modifications

We set out concerns in our update on 20 December 2018 that we consider could be addressed through the modification of specific SLCs. A summary of the reasons for and effects of the proposed modifications are set out in Annex 1. A copy of the draft modifications is set out in Annex 2. We are consulting on modifications to the following SLCs:

- Condition 4. No abuse of the licensee's special position; and
- Condition 42. Independence of the Distribution Business and restricted use of Confidential Information

In summary, the overarching concern highlighted in our update was the potential for any action by, or interaction between, DNOs and their AIDNOs that could negatively affect competition in distribution (or at least, those aspects where competition exists or could exist). For example, this risk could arise if, and to the extent that, the monopoly position of the DNO was used in order to leverage some form of competitive advantage for its AIDNO. Any negative effect on, or distortion of, competition could result in a reduction in consumer choice and or increased prices. This would not be in the interests of consumers. We set out our view that the current licence is not sufficient to address the concerns that we have and which have been raised by some respondents to our consultation.

The proposed modifications would expand the scope of certain licence conditions (SLC 4 and 42) so as to include protections as regards the conduct of distribution activities.

Such protections would exist alongside the protections already offered by competition law. In particular, competition law imposes particular obligations on undertakings found to hold a position of dominance such that their behaviour must not be regarded as abusive.

As noted below in relation to the proposed modifications to SLC 42, companies interested in applying for an AIDNO will wish to consider the possibility that certain corporate structures could have the effect that the DNO and AIDNO could be viewed as separate undertakings under competition law such that the prohibition against 'anti-competitive agreements' set out in Chapter 1 of the Competition Act 1998 and Article 101 of the TFEU might apply.

We consider that the proposed modifications to the licence if duly implemented (following the relevant statutory consultation) would be a proportionate means by which to balance the potential risks and benefits associated with the grant of licences to AIDNOs. In our view, it 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 proposed modifications would build upon our existing powers under SLC6 of the electricity distribution licence to request information from licensees where necessary in the performance of our duties. We will continue to assess the effectiveness of competition in this area and reserve the right to consider further changes if we deem it appropriate to protect consumers' interests.

We would highlight that other modifications to the electricity distribution licence are due to take effect on 1 April 2019. Stakeholders should note our recent decision on changes to the electricity distribution licence for storage.³ The proposed modifications set out in Annex 2 are based on the version of the licence in effect at this time. If we proceed to statutory consultation on the proposed modifications set out in this informal consultation, any

³ [Enabling the competitive deployment of storage in a flexible energy system: decision on changes to the electricity distribution licence](#)

modifications that have taken effect in the electricity distribution licence (in the interim) will be reflected in the statutory consultation.

Next steps

We are inviting views on the proposed modifications to the SLCs of the electricity distribution licence set out in Annex 2. Please provide your views, preferably by email, to david.mccrone@ofgem.gov.uk by **13 March 2019**.

We are particularly keen to hear views on, but not limited to, the following 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?
- Is there alternative wording that you consider would better achieve the intent of our proposals? If so, please provide details and rationale.
- 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.

We will consider all responses received before deciding whether to proceed with a statutory consultation exercise and if so, the scope of such a consultation.

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as confidential. We prefer to receive responses in an electronic form so that they can be placed easily on our website. If you would prefer to reply by post please address this to David McCrone, Ofgem, Commonwealth House, 32 Albion Street, Glasgow G1 1LH.

If you have any questions regarding this letter, please contact David McCrone at david.mccrone@ofgem.gov.uk, in the first instance.

Yours sincerely,

Eleanor Warburton
Deputy Director, Gas, Heat and Emerging Issues, Systems and Networks

Annex 1: summary of our proposed modifications to the electricity distribution licence

We propose to make the following changes to the electricity distribution licence to address our concerns relating to AIDNOs.

Amend SLC 4. No abuse of the licensee's special position

SLC 4 applies to all distribution licensees and outlines the obligations on the licensee to ensure they do not abuse their special position. This includes preventing, restricting or distorting competition in supply of electricity, shipping of gas and generation of electricity.

The proposed modification seeks 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).

The current drafting of SLC 4 does not include 'distribution' which could lead to the conclusion that (at least in terms of this licence condition) a DNO could lawfully provide preferential treatment to its AIDNO to the exclusion or detriment of other distributors. This could adversely impact competition. Licensees would, of course, be subject competition law which imposes particular obligations on undertakings found to hold a position of dominance.

The proposal also seeks to ensure that whilst the DNO is carrying out the activities of establishing and maintaining the Safety and Security of Supplies Enquiry Service; providing Legacy Metering Equipment and providing Data Services), it does not restrict, distort or prevent competition in the distribution of electricity. This will help to promote and secure effective competition in these regards.

We propose to amend SLC 4.1 and 4.4 to include specific reference to distribution to address the concerns we have raised.

Amend SLC 42. Independence of the Distribution Business and restricted use of Confidential Information

SLC 42 applies to DNOs when acting within a DSA. The condition sets out requirements on the DNO as regards the independence of its Distribution Business from affiliates and related undertakings which hold a electricity generation or supply licence or a gas shipper or supply licence (defined as Relevant Licence Holder) as well as restricting access to Confidential Information to the same categories of persons. The condition does not, however, apply to affiliates and related undertakings which are the holder of a distribution licence (e.g. an AIDNO). This means that the condition (and the protections contained within it as regards the independence of the DNO) would not apply as between a DNO and its AIDNO.

The proposed modification seeks to address the risk of exchanges of confidential information, resources and branding between a DNO and its relevant AIDNO. By modifying the definition of Relevant Licence Holder to include Affiliates or Related Undertakings that are the holder of a distribution licence, the scope of the licence condition will also capture AIDNOs.

The reference (within the definition of a Relevant Licence Holder) to the holder of a distribution licence who is not a Distribution Services Provider serves to carve out affiliates and related undertakings of the DNO that are also a DNO acting within another Distribution Services Area. This is because some DNOs have affiliated companies that are DNOs in respect of other Distribution Services Areas. The proposed modification is not designed to impose restrictions between such licensees. This maintains the status quo in this respect.

The proposed modifications also include the expansion of 42.1(a) such that a DNO would not be in breach of the prohibition against information disclosure if it disclosed such

information to all distributors on an equal basis (i.e. not simply to its AIDNO). This would assist in ensuring that there would be a level playing field between distributors and would mitigate the potential for AIDNOs to gain a competitive advantage over other IDNOs through the exchange of the DNO's Confidential Information.

The proposed modifications will have the effect of requiring the DNO to have full managerial and operational independence from the AIDNO, independent branding and managing the transfer of employees from the DNO to the AIDNO.

Licensees will wish to consider the impact of this proposed modification in terms of their treatment under competition law, in particular whether they would be considered to be a separate undertaking from its AIDNO. A number of factors will affect such an assessment including but not limited to the corporate structure within which the DNO and AIDNO fit and the extent of control exercised by their parent company over each of them.

The proposed change to the definition of Relevant Licence Holder to include AIDNOs would also affect the scope of the Compliance Officer's role under SLC 43.

Annex 2: proposed modifications to the electricity distribution licence

For the purpose of this informal consultation, the proposed modifications are marked in red.

Condition 4. No abuse of the licensee's special position

General obligation

4.1 The licensee must at all times manage and operate the Distribution Business in a way that is calculated to ensure that it does not restrict, prevent, or distort competition in the supply of electricity or gas, the shipping of gas, the distribution of electricity, the generation of electricity, or participation in the operation of an Interconnector.

Specific requirements

4.2 Without limiting the general effect of the obligation imposed by paragraph 4.1, the following requirements apply in relation to such of the licensee's activities as are described in paragraphs 4.3 to 4.8.

4.3 In offering terms for agreements to authorise the connection of Metering Equipment to its Distribution System, the licensee must not restrict, distort, or prevent competition in such work.

4.4 In carrying on any of the activities of:

(a) establishing, operating, and maintaining the Safety and Security of Supplies Enquiry Service;

(b) providing Legacy Metering Equipment; and

(c) providing Data Services,

the licensee must not restrict, distort, or prevent competition in the distribution or supply of electricity.

4.5 In setting charges or other terms for the provision of Metering Point Administration Services, the licensee must not restrict, distort, or prevent competition in the generation, distribution, or supply of electricity

4.6 In carrying on any of the activities of:

(a) setting Connection Charges;

(b) setting Use of System Charges; and

(c) providing Non-Contestable Connection Services and information relating to such provision,

the licensee must not restrict, distort, or prevent competition in the generation, transmission, distribution, or supply of electricity, or in participation in the operation of an Interconnector.

4.7 In setting charges or other terms for the provision of Metering Services and Data Services the licensee must not restrict, distort, or prevent competition in the provision of such services, the provision of Metering Equipment and the service of Data Retrieval, or the generation, distribution, or supply of electricity.

4.8 In establishing, maintaining, and operating a Data Transfer Service, the licensee must not restrict, distort, or prevent competition in the provision of, or in any of the markets for,

Metering Equipment, Metering Services, or Data Services, or in the provision of any of the services of Data Aggregation, Data Processing, and Data Retrieval.

Prohibition of cross-subsidy

4.9 The licensee must ensure in carrying on its activities that the Distribution Business does not give any cross-subsidy to, or receive any cross-subsidy from, any other business of:

(a) the licensee; or

(b) any Affiliate or Related Undertaking of the licensee.

Interpretation

4.10 In this condition, any reference to an activity of the licensee includes a reference to that activity to the extent that it is carried on by any third party acting on the licensee's instruction or behalf.

Condition 42. Independence of the Distribution Business and restricted use of Confidential Information

Licensee's obligations

42.1 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 except and to the extent that such information:

- (a) is made available on an equal basis to any [Electricity Distributor](#), Electricity Supplier, gas supplier, or gas shipper;
- (b) is referable to a Customer who at the time to which the information relates was a Customer of the Relevant Licence Holder; or
- (c) is of a type that has been confirmed by the Authority in Writing as corporate information.

Compliance Statement must always be in place

42.2 Except with the Authority's consent, the licensee must at all times have in place a Compliance Statement, approved by the Authority, that describes the practices, procedures, and systems which the licensee has adopted (or intends to adopt) to ensure compliance with paragraphs 42.1.

42.3 If the Authority does not direct the licensee to amend the Compliance Statement within 60 days of receiving it, the statement is to be treated as approved by the Authority.

42.4 The licensee must take all reasonable steps to ensure that it complies with the terms of the Compliance Statement in place under this condition.

Specific contents of the Compliance Statement

42.5 The Compliance Statement must, in particular, set out how the licensee will:

- (a) maintain the full managerial and operational independence of the Distribution Business from any Relevant Licence Holder;
- (b) maintain the branding of the Distribution Business so that it is fully independent from the branding used by any Relevant Licence Holder; and
- (c) manage the transfer of employees from the Distribution Business to any Relevant Licence Holder.

42.6 The Compliance Statement must also ensure that any arrangements to which the licensee is party that fall within any of the descriptions given in paragraph 42.7 are such as to prevent any breach of the requirements of paragraphs 42.1.

42.7 The arrangements referred to in paragraph 42.6 are those that enable any Relevant Licence Holder, or any person engaged in or in respect of the activities of such a Relevant Licence Holder, to have any use of or access to:

- (a) premises or parts of premises occupied by persons engaged in, or in respect of, the management or operation of the Distribution Business;
- (b) systems for recording, processing, or storing data to which persons engaged in, or in respect of, the management or operation of the Distribution Business also have access;

(c) equipment, facilities, or property employed for the management or operation of the Distribution Business; and

(d) the services of any persons who are (whether or not as their principal occupation) engaged in, or in respect of, the management or operation of the Distribution Business.

Revision and publication of Compliance Statement

42.8 The licensee may, with the Authority's approval, revise a Compliance Statement prepared in accordance with paragraph 42.2.

42.9 The licensee must publish a copy of every Compliance Statement prepared in accordance with paragraph 42.2 (or revised in accordance with paragraph 42.8) on its Website (if it has one) within 21 days of its approval by the Authority.

Interpretation

42.10 In this condition:

Confidential Information means information relating to, or derived from, the Distribution Business that is not published or otherwise legitimately in the public domain.

Relevant Licence Holder means any holder of:

(a) a Supply Licence; or

(b) a gas supply licence; or

(c) a gas shipper licence; or

(d) an electricity generation licence; or

(e) an electricity distribution licence and which is not also a Distribution Services Provider

that is also an Affiliate or a Related Undertaking of the licensee.