

All electricity distribution  
licensees and other interested  
parties

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Date: 31 May 2019

Dear colleague,

**Statutory consultation on proposed modifications to the Electricity Distribution Licence related to (a) licence applications from affiliates of existing distribution licensees and (b) competitive deployment of storage**

We published a consultation on proposed modifications to the electricity distribution licence on 13 February 2019 (our '**February consultation**'). This invited views on changes that we considered necessary to address some of the consequences of an affiliate of an existing distribution licensee being granted an electricity distribution licence (an Affiliated Independent Distribution Network Operator or '**AIDNO**').<sup>1</sup>

This letter summarises responses to that consultation and our views. Having carefully considered these comments, we are now publishing a statutory consultation on proposed modifications to the electricity distribution licence.

We consider our updated proposed modifications better achieve the objective of the proposals in our February consultation. Having reflected further and taken into account comments received, however, we consider it more appropriate to implement the proposed modifications via the introduction of a new Standard Licence Condition ('**SLC**') as opposed to modifying a number of different licence conditions. The scope of the licence condition would be clear that it would only apply where an affiliate relationship exists between distribution licensees. In our view, this makes the proposed obligations clearer and reduces the risk of unintended consequences.

Separate to the proposed modifications for AIDNOs, the statutory consultation also contains proposed modifications relating to our decision on enabling the competitive deployment of storage in a flexible energy system.<sup>2</sup> These are two minor housekeeping changes that should have been made when we previously consulted on this policy area.

**Background**

On 24 July 2018, we published our initial thoughts on the potential consequences of an affiliate of an existing distribution licensee applying for and holding an electricity

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<sup>1</sup> [https://www.ofgem.gov.uk/system/files/docs/2019/02/informal\\_consultation\\_on\\_affiliate\\_licence\\_changes.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/02/informal_consultation_on_affiliate_licence_changes.pdf)

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-enabling-competitive-deployment-storage-flexible-energy-system-changes-electricity-distribution-licence>

distribution licence.<sup>3</sup> We sought views from stakeholders on the potential implications of AIDNOs being granted a licence and this helped inform our 'Update on our consultation on electricity distribution licence applications from affiliates of existing licensees' ('**update**') on 20 December 2018.<sup>4</sup>

We said in that update that the granting of distribution licences to AIDNOs could result in some benefits for consumers, such as increased competition in the distribution sector. However, we also noted that clear and appropriate protective measures were necessary to ensure that such competition was effective and that consumers' interests were protected. Such protections would be to address the risks associated with the DNO acting in a manner that leveraged its monopoly position as DNO to the commercial benefit of its AIDNO (eg, by sharing commercially sensitive information as regards their distribution network).

We also said any protective measures introduced by way of licence modifications would exist alongside the existing protections offered by competition law. Of particular relevance in this context are the obligations placed upon undertakings which hold a position of dominance. Those undertakings must not behave in an abusive manner.

Following this, we published our February consultation setting out proposed modifications to the electricity distribution licence. Our view was that the proposed modifications were a proportionate means of balancing the potential risks and benefits we had identified in relation to the granting of distribution licences to AIDNOs. We invited views from stakeholders on whether:

- the proposals would help mitigate the risks identified
- alternative wording would better achieve our intent
- any further additional changes were required.

## **Respondents' views**

We received thirteen responses to our February consultation. The nine responses marked non-confidential have been published on our website.

We have summarised all of the responses in Annex 1 along with our views on the points raised. Where a respondent did not explicitly refer to a question, we have summarised their comments under what we consider is the most relevant heading.

## **Changes to the proposed modifications since the February consultation**

As referred to above, having reflected further and fully considered respondents' views, we propose to implement the modifications via the introduction of a new licence condition rather than making multiple changes across different licence conditions. We consider this approach to be more effective, proportionate and transparent.

The new SLC condition would introduce a general obligation requiring licensees to (at all times) manage and operate their Distribution Business in a way that is calculated to ensure that it does not restrict, prevent or distort competition such that its AIDNO is or may be advantaged as compared to any other Electricity Distributor.

The introduction of this general obligation would make it clear that if distribution licensees were to act in an anti-competitive manner which may provide an advantage to its AIDNO it would be acting in breach of its licence.

The remainder of the new condition would set out a number of specific requirements. The scope of these requirements would broadly replicate the effect of the modifications that

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<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/independent-distribution-network-operators-licence-applications-affiliates-existing-licensees>

<sup>4</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/12/aidno\\_decision\\_-\\_final\\_version.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/12/aidno_decision_-_final_version.pdf)

were proposed in the February consultation. These include (but are not limited to) that the licensee:

- must have in place the systems and processes that prevent the sharing of Confidential Information with an AIDNO (except in the limited circumstances described in the licence condition). Confidential Information is information relating to (or derived from) the DNO’s business that is not in the public domain.
- must have in place a Compliance Statement setting out how it will achieve compliance with the requirement not to disclose Confidential Information, including ensuring the full managerial and operational independence of the DNO from the AIDNO.
- must appoint, following consultation with the Authority, a competent and sufficiently independent person to act as an AIDNO Compliance Officer for the purposes of facilitating compliance with the requirement not to disclose Confidential Information, including being responsible for reporting on an annual basis.
- in light of the similarities as regards the scope of the AIDNO Compliance Statement with the compliance statement to be prepared under SLC 42 and the similarities between the role of the AIDNO Compliance Officer and the compliance officer under SLC 43, the new licence condition specifically provides that the compliance statements may be in substantially the same or similar form and that the compliance officer role may be performed by the same person.

The proposed licence condition would only apply to those distribution network operators (DNOs) which have an Affiliate who holds a distribution licence, but that Affiliate is not a Distribution Services Provider. The proposed condition would only apply in respect of activities within the licensees’ Distribution Service Area i.e. it would not apply in relation to activities undertaken by a licensee acting outside of its ‘host DNO area’.

For ease of comparison, the changes from our February consultation are summarised below.

| <b>February consultation</b>                              | <b>Our updated proposal</b>  |
|---|--|
| -   | Insert new SLC53   |
| Amend SLC4.1 to include “the distribution of electricity” | We no longer propose to amend SLC4.1.<br><br>The proposed introduction of a general obligation in SLC53 not to distort competition in a way that would confer an advantage on an AIDNO is intended to achieve the same protection.   |
| Amend SLC4.4 to include “the distribution” of electricity | We no longer propose to amend SLC4.4.<br><br>On further reflection, these modifications are not considered necessary in light of current protections which exist in relation to these types of service in other licence conditions (as set out below): <ul style="list-style-type: none"> <li>• Safety and Security of Supplies Enquiry Service – SLC8</li> <li>• Legacy metering Equipment – SLC34</li> <li>• Data Service – SLC35.</li> </ul>  |
| Amend SLC42.1 to include “Electricity Distributor”        | We no longer propose to change SLC42.1.<br><br>The proposed introduction of the various specific obligations in SLC53 (including the obligation not to disclose Confidential Information, prepare and implement a Compliance Statement, etc) are intended to achieve broadly the same protections as would achieved by the modification of SLC42. To note that there are some minor differences as regards the scope of SLC53 as compared to SLC42 (eg, in relation to requirements for separate |

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|---|--|
|   | branding and the extent of the requirements as regards the compliance officer).  |
| Amend SLC42.10 to expand the definition of Relevant Licence Holder" | We no longer propose to amend SLC42.10.<br><br>The intended effect of that particular modification (to capture the relationship between DNO and AIDNOs) would be achieved with the scope of the new SLC53. |

### **Housekeeping changes related to the competitive deployment of storage**

We are also proposing two minor housekeeping changes to SLC31C and SLC43. These have been identified since publishing our decision on changes to the electricity distribution licence to ensure that distribution network operators cannot operate storage. We consider that these changes are minor in nature and this represents a timely opportunity to propose making them. The changes will replace references to "Relevant Licence Holders" with references to "Relevant Undertakings" in both licence conditions. These changes do not affect the policy intent of the two licence conditions.

### **Structure of this statutory consultation**

There are four annexes to this letter:

- Annex 1 summarises the responses received to the February consultation and our views. This provides further reasoning as regards the proposed licence modifications.
- Annex 2 sets out a Notice of a statutory consultation on a proposal to modify the Electricity Distribution Licence.
- Annex 3 sets out the text of our proposed licence modifications on storage.
- Annex 4 sets out the text of our proposed licence modifications on AIDNOs.

### **Views invited and next steps**

We are inviting views on the proposed modifications to the electricity distribution licence set out in Annexes 3 and 4. Please provide your views, preferably by email, to [david.mccrone@ofgem.gov.uk](mailto:david.mccrone@ofgem.gov.uk) on or before **28 June 2019**.

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@ofgem.gov.uk](mailto:david.mccrone@ofgem.gov.uk) in the first instance.

Yours faithfully,

**Eleanor Warburton**  
**Deputy Director, ESO and Gas Systems, Systems and Networks**

## **Annex 1: summary of responses to our February consultation and our views**

### **Q1. 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?**

The majority of respondents agreed with the intent of our proposals and that it was important to address the concerns we had identified. While some respondents agreed with the proposed licence modifications, and that our proposals were proportionate without being overly burdensome, eight respondents expressed concerns that the proposals did not go far enough. These respondents highlighted a number of themes that they did not consider were fully addressed by our proposals. One respondent highlighted that any proposals should be proportionate and only take effect in circumstances where a DNO has a relationship with an AIDNO.

#### Resource sharing between DNO and AIDNO

##### *Respondents' views*

Five respondents argued that our proposals were not sufficient, as they would not prevent the DNO and the AIDNO from sharing resources. They felt the restriction on sharing should go beyond Confidential Information as currently defined in the licence and cover people, knowledge, premises and IT systems (including common websites). Two respondents extended the scope of sharing further and stated that common branding between the DNO and AIDNO should not be allowed. Finally, one respondent noted that the proposed modifications would not deal with implicit unstated shared understandings between DNOs and AIDNOs.

One respondent stated that there are areas where costs could be shared and the requirement was only on the licensee to report any sharing. One respondent stated we should make further amendments to SLC42 to ensure there is an explicit ban on sharing common resources. Three respondents argued the AIDNO would have a cost advantage as a result of sharing resources (eg, avoiding or minimising sunk costs that have been met by other IDNOs in establishing their business) and therefore SLC42 must be amended, or that such resources should be provided on an equal basis to any other IDNO.

Two respondents stated the original intent of SLC42 did not take into consideration the separation issues associated with licensees working within the same industry sector, and rather it was designed for separation between vertically integrated generation, network and supply businesses.

##### *Our view*

Our overarching comment is that the scope of the protections that we are seeking to introduce by way of licence modification are designed to address the specific risks that we have identified and which may not be covered by existing licence conditions. We remain of the view that the greatest scope for harm is where an AIDNO is able to obtain information from the DNO which is unavailable to other IDNOs.

We recognise that disclosure of confidential information (eg, as to the existence (or otherwise) of constraints on the network, or potential opportunities for new business for the AIDNO) could adversely impact competition. More specifically, it could provide the AIDNO with some form of advantage as compared to its competitors. Any such distortion of competition would undermine the existence and development of effective competition. This could ultimately result in current unaffiliated IDNOs being squeezed out of the market, or new companies being discouraged from entering. The long term impact of this could be that customers would have reduced choice when seeking a connection provider, lowering the competitive pressure on the remaining parties to provide a quality service. In our view, this is not in the interests of consumers.

We believe the proportionate approach to the issue of sharing of resources is to prevent this if it distorts competition. For this reason, the protections that we are seeking to introduce do not explicitly ban the sharing of resources between a DNO and AIDNO.<sup>5</sup> Instead, they are focused on ensuring that any such sharing of resources will only be permitted subject to the licensee still being able to demonstrate compliance with the prohibition against the disclosure of Confidential Information by the DNO to its AIDNO, and its compliance with the general obligation not to act in a manner that would distort competition such that the AIDNO would obtain an advantage as compared to other Electricity Distributors.

More specifically, the protections that the proposed new standard licence condition would provide include:

- Requirement on the licensee to manage and operate its Distribution Business in such a way that does not restrict, prevent or distort competition such that an AIDNO is or may be advantaged as compared to any other Electricity Distributor
- Prohibition on the disclosure of Confidential Information from the DNO to its AIDNO except in limited circumstances including where such information is disclosed on an equal basis amongst Electricity Distributors
- Requirement on the licensee to put in place relevant compliance procedures and report on how they comply with its obligations under the proposed licence condition.

Our view is that the practical effect of these provisions will be that resource sharing that could have a negative impact on competition should be prevented. It will be up to the licensee to demonstrate how they achieve this but our expectation is that it could include measures such as restricting staff of one business access to the IT systems or offices of another.

For the avoidance of doubt, one further change from the proposals in our February consultation is that SLC42 included restrictions on shared branding, whereas our proposed new condition does not. In creating a new standalone licence condition (rather than seeking to modify an existing condition), we are keen to ensure that the condition is targeted to address the specific concerns we have identified. Provided that the licensees comply with existing licence conditions (see below) and their competition law obligations we do not consider it necessary to mandate separate branding.

Existing licence conditions which are relevant in this context include SLC4.6, SLC19, SLC14 (all referring to the provision of Non-Contestable Connection Services) and SLC52 (which requires the licensee to facilitate competition for Contestable Connection Activities). These are in addition to other obligations under SLC34 (provision of legacy metering services) and SLC35 (provision of data services). As noted above, we consider that the cumulative effect of these conditions, complimented by our proposed licence modification and wider obligations under competition law, are a sufficient and proportionate means of achieving our aims.

Finally, we acknowledge that when SLC42 was introduced it was designed to address issues arising from vertical integration. While we do not agree that this prevents its application to parties within the same sector (as per the modifications previously suggested to SLC42) we consider that the insertion of a new licence condition which delivers the same intended effect addresses any concerns that parties may have as to the intended scope of SLC42.

#### Risk of preferential treatment

Two respondents stated Ofgem's potential licence changes do not prevent DNOs referring customers to the AIDNO (over other IDNOs). One respondent stated there is the possibility for the DNO to withdraw from providing certain connections, referring these to the AIDNO if it is more profitable to do so.

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<sup>5</sup> "Resources" in this context can include property, systems and people.

One respondent stated that a DNO and AIDNO must interact with each other in a manner that is transparent and on equal footing as to how they interact with others.

### *Our view*

DNOs have an existing obligation to facilitate competition in the procurement and provision of contestable work within their distribution area.<sup>6</sup> They must, to the fullest extent possible, allow this competition, clearly indicating what services fall under this category and which services only they can provide.

We consider that opening the scope of services that can be provided by parties other than just the DNO has brought benefits for consumers and has the potential to continue to do so. Existing arrangements allow for competition in contestable work and network ownership, and we intend to ensure that the DNO and AIDNO do not act in such a way that negatively impacts existing arrangements.

It is acknowledged that reduced competition could potentially come about by the DNO referring customers only to their AIDNO, or by only notifying their AIDNO of potential new opportunities. We think this would be against the customer's best interests as they would not be aware of all options when seeking a connection. There may also be a risk that customers would be more likely to take a DNO's referral given the reputation gained by virtue of its long term position in a given region. Furthermore, giving preferential treatment to a party or group of parties over another, where it negatively impacts effective competition, is not in consumers' interests

If this were to happen, it could, in the long term, result in reduced choice for consumers, higher prices than would otherwise be the case or a lower quality of service. It is important therefore that DNOs interact with AIDNOs on the same basis they would with any other IDNO.

SLC52 already requires the DNO to facilitate competition in the Local Connections Market through removing, to the extent it is within its power to do so, barriers associated with managing and operating its Distribution Business which would prevent entry to, or continued participation in, such markets. Our view is that compliance with this obligation, in addition to other changes we proposed, would prohibit the DNO from referring customers only to its AIDNO.

To the extent that (notwithstanding the protections offered under SLC52 and the Competition in Connections Code of Practice), there remained some concern that licensees could seek to favour their affiliate IDNOs - e.g. in the context of new business opportunities - we consider that the proposed introduction of the general obligation would address this risk. To recap, the general obligation would require a licensee to manage and operate its Distribution Business in a way that would not restrict, prevent or distort competition such that an AIDNO is or may be advantaged as compared to any other IDNO. We consider that this should apply at all stages of the connections process and over the lifetime of an asset. This is consistent with the wording of SCL52, which defines Contestable Connection Activities as the activities associated with the provision, modification and retention of a connection.

### Separation in code governance

#### *Respondents' views*

Two respondents identified the need to ensure AIDNOs are separate from the DNOs in code governance in order to avoid conflict of interest in situations where an AIDNO and DNO may be expected to express common views. One said that affiliate status needs to be recognised in the code governance processes to avoid any conflict of interests.

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<sup>6</sup> SLC52 Competition in Connections Code of Practice

### *Our view*

Each distribution licensee is granted a licence separate to that of another distribution licensee. As such, they will need to become a party to relevant industry codes as separate signatories from the DNOs.

Each code sets out its own rules for governance and administration. Where a code is subject to open governance signatories are free to propose further changes for AIDNOs in code governance, if they believe these would better facilitate the relevant objectives of the code. The code administrator is responsible for facilitating this modification process and assisting parties to understand their code obligations.

### **Q2. Is there alternative wording that you consider would better achieve the intent of our proposals?**

#### Proposed changes potentially create unforeseen consequences for all relevant licence holders

Two respondents expressed concerns over potential unintended consequences they considered that the proposed licence modifications could have. One of these respondents explained that they were concerned with new obligations applying to all licensees, even in the event a DNO is not affiliated to another electricity distribution licensee. Their preference is to have new obligations which only take effect when a separate AIDNO licence is granted, and only apply when AIDNOs are operating within the DNO's Distribution Services Area ('**DSA**'). Where the AIDNO only operates outside of the DNO's DSA, the respondent believed that SLC4 and general competition law would be sufficient. They also saw no distinction between the definition of a Distribution Services Provider (DSP) and the holder of an electricity distribution licence, and suggested we define AIDNOs separately.

The second respondent expressed concern over our modification including a reference to the distribution of electricity in SLC4.1. They explained that by the very nature of DNOs being regulated monopolies they, to some extent, would automatically be in breach of the modified SLC4.1. They suggested alternative wording to address this point.

### *Our view*

We consider that our proposal to insert SLC53 in place of the changes that were set out in the informal consultation addresses these concerns. While we think that the substantive effect of the proposed modifications is broadly the same, it will set out explicitly the circumstances in which it applies. We consider that this provides licensees with clarity and avoids the risk of any unintended consequences. Our new proposal will only have effect if a DNO has an AIDNO, therefore not placing any intended obligations on DNOs that do not have such a relationship. For the avoidance of doubt, all licensees would remain subject to their obligations under competition law which imposes particular obligations on undertakings that are dominant.

Our view on the differences between the definitions of a DSP and the holder of an electricity distribution licence differs from the respondent. SLCs found within Section B of the electricity distribution licence (including SLC42) are applicable to DSPs only and therefore not all electricity distribution licensees. We therefore disagree with the respondent's interpretation of DSP and a holder of an electricity distribution licence.

We provide our views on operation within the DSA below.



### **Q3. Do you consider that further modifications (in addition to those set out in this consultation) are required?**

#### Need for further guidance

##### *Respondents' views*

Four respondents requested that we publish a business separation or regulatory guidance document in place for the DNO and AIDNO. One respondent also stated the guidance should be binding on the DNO and could be amended over time if circumstances change. Two respondents also highlighted that Ofgem should have the powers in place to act should issues arise.

Respondents noted the document should set out how shared services should be separated, including restrictions on the DNO to ensure any services provided to an AIDNO are provided to IDNOs. One respondent also stated that we should make clear that we would seek additional reassurance in the Compliance Statement regarding any services a DNO may provide to any AIDNO in its DSA.

One respondent provided details on the type of evidence set out in the guidance document that Ofgem should expect to see to support the Compliance Statement. This includes data on anonymised employee records, shared property portfolio, IT and shared services manifest and brand separation. Finally, one respondent stated staff at all levels need to be trained to ensure they understand boundaries relating to their interactions internally and externally.

##### *Our View*

We acknowledge the potential value in considering a guidance document should matters develop such that there appeared to be any misunderstanding as to the scope and effect of the proposed licence conditions. While we have set out changes to our original proposed conditions to clarify its application, we do not have any evidence to suggest a further guidance document is necessary at this time.

With regards to the provision of various services, we note that the licence already contains a number of specific obligations on DNOs (eg, SLC15 Standards for the provision of Non-Contestable Connection Services). We do not consider it appropriate to prescribe within the licence the ways in which resources and or services can or cannot be shared between a DNO and AIDNO. There could be instances where this might be appropriate (such as shared corporate functions). However, any sharing or provision of services that does occur between the DNO and AIDNO must not compromise the ability of the licensee to meet its obligation regarding non-disclosure of Confidential Information (as well as wider obligations under the licence and competition law). We consider this is a proportionate way of addressing the potential harm that we have identified.

Regarding our powers to act in the event of suspected breach, these already exist. We have published enforcement guidelines setting out where we will investigate and, if necessary, take action if we believe that a regulated person may be in breach of their obligations.<sup>7</sup>

#### Requirement for a rigorous monitoring regime

Four respondents stated that there is a requirement for a stronger monitoring regime with some stating we must have the power for enforcement. One respondent argued the current Compliance Statement alone is not sufficient whilst another respondent noted it may be difficult for Ofgem to undertake enforcement for shared common resources between a DNO and AIDNO.

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<sup>7</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/10/enforcement\\_guidelines\\_october\\_2017.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/enforcement_guidelines_october_2017.pdf)

Some respondents thought it was unlikely that Ofgem could monitor resource sharing effectively without significant additional resource. Due to these factors, the respondents stated this distorts the idea of a 'level playing field' for all market participants.

Three respondents argued Ofgem would need to undertake a review of the AIDNO between every 3-5 years whilst one stated audits must be undertaken at start-up and annually.

#### *Our View*

We have controls in place to undertake monitoring activities, request information and investigate suspected breaches of licence conditions in accordance with our enforcement guidelines and powers under competition law. We also have the right to undertake reviews to make further changes to the licence should concerns arise. The change we are proposing will complement these existing powers to enforce against licensees, where there is clear evidence of a breach. Parties are also free to raise concerns with us directly where they think there is a breach of the licence or competition law.

In addition to this, the proposed licence condition will include a requirement for licensees to appoint a competent and sufficiently independent person as Compliance Officer. We must also be consulted on this appointment. The Compliance Officer must provide an annual report setting out how compliance with the proposed condition has been achieved. The licensee must then prepare an AIDNO Compliance Report based on the Compliance Officer's findings which is submitted to the Authority and published on the DNO's website. This will further support our other monitoring activities.

#### Limiting AIDNOs to operating outside an affiliated DNO's DSA

One respondent highlighted their disappointment in seeing that Ofgem has not restricted the ability of an AIDNO to operate within the DNOs' DSA. Two respondents stated they had concerns around AIDNOs operating within the affiliated DNOs' DSA. The concerns being the same as those described in response to the first question.

Additionally, one respondent highlighted the potential for the AIDNO to gain a competitive advantage beyond the DSA because all DNOs are regulated and have general obligations on pricing and other activities. If the AIDNO gains knowledge from the DNO, it could be used to gain insights about pricing and activities common to all DNOs.

#### *Our view*

Provided the AIDNO isn't afforded an unfair advantage as a result of its relationship to the DNO then in our view it is in the interests of consumers to allow increased competition (across GB) between DNOs and IDNOs. We consider that our approach (to rely on competition law plus the proposed changes to the licence) is a proportionate way in which to address this risk. We consider that additional restrictions on where an AIDNO can operate could stifle competition and reduce customer choice (eg, where potential projects cross DSA boundaries).

#### Proposed changes to SLC31B

One respondent agreed with the proposed modifications stating they were appropriate without being burdensome. However, they suggested we should also modify SLC31B in a similar way to that proposed for SLC42 to place a reciprocal obligation on the AIDNO.

#### *Our view*

We understand that the respondent's rationale for this change is that it places a reciprocal obligation on the AIDNO (eg, to avoid sharing of confidential information by the AIDNO in favour of the DNO). While we can understand the rationale for the respondent's suggestion, we consider that introducing a new obligation on the DNO is a targeted and proportionate

solution given the risks identified relate to the distortion of competition (between distribution licensees) as a result of the actions of the DNO (not the AIDNO). For the avoidance of doubt, the AIDNO would be bound by its other obligations under the licence and competition law.

#### **Q4. Other issues raised in the consultation and our response**

##### Consumer benefits of AIDNOs

###### *Respondents' views*

One respondent was against the general principle of granting AIDNOs a licence and stated, if AIDNOs exploit the regime, consumers are unlikely to benefit.

###### *Our view*

When we receive an application for a distribution licence, we assess it in accordance with our published guidance.<sup>8</sup> In doing this we comply with our principal objective of protecting the interests of existing and future consumers, where appropriate, having regard to various matters including promoting effective competition.

We also consider a number of other criteria, including the extent to which consumers' interests would be better protected in a manner other than promoting competition. These include our aim of minimising regulatory burden and maximising the opportunity for new applicants' to enter the energy market, including those based outside of Great Britain.

As set out above, whilst we recognise the potential risks associated with the grant of a distribution licence to AIDNOs, our assessment needs to consider the issue in the round and as such, also takes account of the positive outcomes that could materialise both for competition and consumers. Our proposed licence modifications are designed to be a proportionate way in which to address the risks whilst providing for the possibility of such positive outcomes.

We do not think the risk of consumer detriment is limited to AIDNOs. If any licensee was to act in such a way that negatively impacted competition, this would not be in consumers' interest. The licence provides protection to consumers but it cannot consider every possible future change that might happen. We, therefore, have to react to new issues as they emerge and, where necessary, consider whether changes to the existing obligations are required.

Our proposed amendments seek to mitigate such a risk – the possibility of a DNO and AIDNO acting in a way that is not in consumers' interests. Without such amendments, licences that are granted would be with no additional obligations. In line with our principal objective, we consider that these amendments will protect the interests of existing future electricity consumers better than if they were not made.

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<sup>8</sup> <https://www.ofgem.gov.uk/ofgem-publications/59439/supplementaryappendix2-guidanceforgasnd0electricityapplicationspdf>

## **Annex 2: Notice of statutory consultation**

**To: All holders of an electricity distribution licence**

### **Electricity Act 1989 Section 11A(2)**

#### **Notice of statutory consultation on a proposal to modify the standard licence conditions of all electricity distribution licences**

1. The Gas and Electricity Markets Authority ('the Authority')<sup>1</sup> proposes to modify the standard conditions of all electricity distribution licences granted or treated as granted under 6(1)(c) of the Electricity Act 1989 by amending standard conditions 31C 'Appointment of Compliance Officer' and 43 'Appointment of Compliance Officer', and inserting a new standard licence condition 53 entitled 'Affiliate independent distribution network operators'.
2. The effect of the proposed modification to standard conditions 31C and 43 is to make a minor housekeeping change to align the wording of changes that were implemented previously. That is, replacing 'Relevant Licence Holders' with 'Relevant Undertakings' in both licence conditions.
3. With regards to proposed standard condition 53, we are proposing this modification to ensure that the licence better protects consumers' interests and competition in the distribution sector in the event of an affiliate of an existing distribution licensee being granted an electricity distribution licence. In the absence of the proposed modifications, we consider that a distribution licensee may be able to act in a manner that unduly favours its affiliate distribution licensee eg by sharing confidential information with the affiliate distribution licensee (AIDNO). This could have the effect of placing such AIDNOs at a competitive advantage as compared to other distribution licensees. Such distortion of competition would not be in the interests of consumers.
4. The effect of these proposed modifications would be to require the licensee, where it has an affiliate that is a distribution licensee (but not a Distribution Services Provider) and in relation to activities in its Distribution Services Area, to:
  - manage and operate its Distribution Business in such a way that does not restrict, prevent or distort competition such that an AIDNO is or may be advantaged as compared to any other Electricity Distributor
  - prohibit the disclosure of Confidential Information by the licensee to the AIDNO except where that information is available to other electricity distributors on equal basis or been identified as information to which the AIDNO is permitted access
  - have in place a compliance statement (approved by the Authority) setting out how it will achieve compliance with the obligation not to disclose Confidential Information, including maintaining full managerial and operational independence of the Distribution Business from the AIDNO and managing the transfer of employees from the Distribution Business to the AIDNO.
  - appoint a sufficiently independent and competent person who will act as the AIDNO Compliance Officer and who will be responsible for reporting annually to the licensee's directors on compliance with the condition.
  - Prepare an AIDNO Compliance Report (after receiving the AIDNO's compliance officer's report) setting out the licensee's compliance including details of any investigations conducted by the compliance officer. A copy of the licensee's report must be provided to the Authority and published on the licensee's website.
5. A copy of the proposed modification has been published on our website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). Alongside this consultation, we have published a covering

letter together with a summary of responses received to our previous informal consultation and our views on such responses. Alternatively, they are available from [foi@ofgem.gov.uk](mailto:foi@ofgem.gov.uk).

6. Any representations with respect to the proposed licence modifications must be made on or before **28 June 2019** to David McCrone, Office of Gas and Electricity Markets, Ofgem, Commonwealth House, 32 Albion Street, Glasgow, G1 1LH or by email to [david.mccrone@ofgem.gov.uk](mailto:david.mccrone@ofgem.gov.uk).
7. 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 not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
8. If we decide to make the proposed modification, it will take effect not less than 56 days after the decision is published.

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**Eleanor Warburton**  
**Deputy Director, ESO and Gas Systems, Systems and Networks**  
**Duly Authorised on behalf of the Gas and Electricity Markets Authority**  
**31 May 2019**

### **Annex 3: proposed modifications to the electricity distribution licence related to storage**

We propose to modify the standard conditions below. Deletions are shown in strike through and new text is double underlined.

#### **SLC 31C – Appointment of Compliance Officer**

31C.13 For the purposes of this condition, Relevant Obligations means:

(a) the requirements of standard condition 31B (Independence of Distribution Business and restricted use of Confidential Information);

and, so far as they relate to relationships with Relevant Undertakings ~~License Holders~~ within the meaning of standard condition 31B, the requirements of:

(b) paragraph 9 of standard condition 4 (No abuse of the licensee’s special position) (which prohibits cross-subsidy between the licensee’s Distribution Business and any other business of the licensee or of an Affiliate or Related Undertaking of the licensee); and

(c) Paragraph 1 of standard condition 19 (Prohibition of discrimination under Chapters 4 and 5) (which prohibits the licensee from discriminating between any person or class or classes of persons when providing Use of System or connections or carrying out works for the purposes of connection).; and

(d) the requirements of standard condition 31D (Prohibition on Generating by Licensee).

#### **SLC 43 – Appointment of Compliance Officer**

43.12 For the purposes of this condition, Relevant Requirements means:

(a) the requirements of standard condition 42 (Independence of Distribution Business and restricted use of Confidential Information);

and, so far as they relate to relationships with Relevant Undertakings ~~License Holders~~ within the meaning of standard condition 42, the requirements of:

(b) paragraph 9 of standard condition 4 (No abuse of the licensee’s special position) (which prohibits cross-subsidy between the licensee’s Distribution Business and any other business of the licensee or of an Affiliate or Related Undertaking of the licensee);

(c) paragraph 1 of standard condition 19 (Prohibition of discrimination under Chapters 4 and 5) (which prohibits the licensee from discriminating between any person or class or classes of persons when providing Use of System or connections or carrying out works for the purposes of connection); and

(d) paragraphs 1 and 3 separately of standard condition 41 (Prohibition of discrimination under Chapter 9) (which prohibit the licensee from discriminating between any person or class or classes of persons when providing, respectively, Legacy Metering Equipment and Data Services).; and

(e) the requirements of standard condition 43B (Prohibition on Generating by Licensee).

## **Annex 4: proposed modifications to the electricity distribution licence related to AIDNOs**

We propose to insert the new standard condition below.

### **SLC 53 – Affiliate independent distribution network operators**

#### **Application**

53.1 This condition applies in the event that the licensee has an Affiliate which also holds a distribution licence but such Affiliate is not a Distribution Services Provider (an “Affiliate IDNO”).

53.2 This condition only applies in relation to the licensee’s activities in its Distribution Services Area.

#### **General obligation**

53.3. 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 such that an Affiliate IDNO is or may be advantaged as compared to any other Electricity Distributor or an Electricity Distributor is or may be disadvantaged as compared to the Affiliate IDNO.

#### **Specific Obligations**

##### **Restricted use of Confidential Information**

53.4 The licensee must put in place and at all times, maintain managerial and operational systems that prevent any Affiliate IDNO from having access to Confidential Information except and to the extent that such information:

- a) is made available on an equal basis to all Electricity Distributors;
- b) is referable to a customer who at the time to which the information relates was a customer of the Affiliate IDNO; 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**

53.5 Except with the Authority’s consent, the licensee must at all times have in place an Affiliate IDNO Compliance Statement, approved by the Authority, that describes practices, procedures, and systems which the licensee has adopted (or intends to adopt) to ensure compliance with paragraph 53.4. The AIDNO Compliance Statement may be in the same or substantially similar form to the Compliance Statement prepared under condition 42.

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

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

##### **Specific contents of the Compliance Statement**

53.8 The Affiliate IDNO Compliance Statement must, in particular, set out how the licensee will:

- a) maintain the full managerial and operational independence of the Distribution Business from the Affiliate IDNO; and
- b) manage the transfer of employees from the Distribution Business to an Affiliate IDNO.

53.9 The Affiliate IDNO Compliance Statement must also ensure that any arrangements to which the licensee is party that fall within any of the descriptions given in paragraph 53.10 below are such as to prevent any breach of the requirements of paragraph 53.4 above.

53.10 The arrangements referred to in paragraph 53.9 are those that enable any Affiliate IDNO, or any person engaged in or in respect of the activities of such an Affiliate IDNO, 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**

53.11 The licensee may, with the Authority's approval, revise an Affiliate IDNO Compliance Statement prepared in accordance with paragraph 53.5.

53.12 The licensee must publish a copy of every Affiliate IDNO Compliance Statement prepared in accordance with paragraph 53.5 or revised in accordance with paragraph 53.11) on its website within 21 days of its approval by the Authority.

### **Compliance Officer**

53.13 The licensee must ensure, following consultation with the Authority, that a competent person (who is to be known as the AIDNO Compliance Officer) is appointed for the purposes of facilitating the licensee's compliance with the requirements of this condition.

53.14 Subject to paragraph 53.16, the licensee shall be entitled to appoint the same person to act as the AIDNO Compliance Officer as it has appointed to act as the Compliance Officer under condition 43.

53.15 The licensee must at all times ensure that the AIDNO Compliance Officer is engaged for the performance of such duties and tasks as the licensee considers it appropriate to assign to him for the purpose specified in paragraph 53.13 including but not limited to reporting annually to the licensee's directors about his activities during the period covered by the report.

53.16 The licensee must ensure that the AIDNO Compliance Officer is sufficiently independent, adequately resourced and provided such access to premises, systems, information and documentation as is needed for the fulfilment of duties and tasks assigned to him.

53.17 The licensee must, after receiving each annual report of the AIDNO Compliance Officer, produce a report (the "AIDNO Compliance Report") about its compliance during the relevant year with the requirements under this condition and its implementation of



the practices, procedures and systems adopted in accordance with the Affiliate IDNO Compliance Statement. It must also set out details of any investigations conducted by the Compliance Officer.

53.18 The licensee must provide the Authority a copy of every AIDNO Compliance Report and publish each such report on, and in a way that is readily accessible from, its website.

### **Derogation**

53.19 The Authority may (after consulting the licensee and, where appropriate, any other materially affected party) issue a direction ('a derogation') to the licensee that relieves it of its obligations under this condition to such extent, for such period of time, and subject to such conditions as may be specified in the direction.

### **Interpretation**

53.20 For the purposes of this condition:

|                                     |   |
|-------------------------------------|---|
| Affiliate IDNO                      | has the meaning set out in paragraph 53.1;  |
| Affiliate IDNO Compliance Statement | means the compliance statement to be prepared under paragraph 53.5;   |
| AIDNO Compliance Officer            | means the compliance officer appointed by the licensee in terms of paragraph 53.13;   |
| Confidential information            | means information relating to, or derived from, the DNO's Distribution Business that is not published or otherwise legitimately in the public domain. |