

Ofgem ED3 Framework Consultation¹
Piclo Response

Dear Ofgem,

Thank you for the opportunity to respond to Ofgem's framework consultation on electricity distribution price control (ED3). We are happy for this response to be published.

There are three overarching points we would emphasise, ahead of our detailed responses:

- **Britain is a global leader on smart networks.** Since the mid 2010s, the combination of forward-thinking policy from the UK Government and a regulatory environment which incentivises Distribution Network Operators to embrace flexibility has created a rich ecosystem. Piclo is one product of this - we are a cleantech scale-up, with an HQ in London, and are exporting our know-how and expertise internationally including to the US and Australia. This smart energy sector is overlooked as an area where Britain has competitive advantage. Our peers include EV.energy, Oaktree Power and of course Octopus, among others. To continue to grow this home market, Ofgem should continue with a totex model which incorporates additional incentives, to encourage the DNOs and NESO to move even faster.
- **An emphasis on flexibility should continue.** Certain stakeholders have already interpreted Ofgem's framing of this consultation as a move away from the "flexibility first" approach of ED2. We strongly encourage Ofgem to ensure both the messaging and the detail of ED3 continue to emphasise and reward a flexibility first approach. This is consistent with analysis presented by NESO, and adopted by the UK Government, for the Clean Power 2030 strategy.
- **The consultation appears to suggest there is a trade off between flexibility and grid reinforcement.** We do not agree. Both are needed for a secure, modern grid. Flexibility is an important approach to minimise the investment, and therefore the cost, of the energy transition. And it is also key for operating the grid. Network deferral is not the only reason why flexibility is important.

¹ <https://www.ofgem.gov.uk/consultation/framework-consultation-electricity-distribution-price-control-ed3>

Detailed responses:

1. Do you agree with our characterisation of the wider context for ED3? Are there any other areas of context that you consider material for ED3?

Yes, we would agree for the context of ED3, but would also highlight the context of NESO as a key buyer also influencing flexibility.

- **Demand and decentralised energy:** We agree that forecasts of doubling if not tripling of capacity to meet electricity demand out to 2050 is a key macro trend.
 - **System flexibility and connections.** The DNOs have been increasing the amount of flexibility they are procuring, with Piclo playing a key part in supporting that process. Whilst the DNOs had uncontracted demand, it is also true that there is still untapped capacity from consumer and distributed energy resources.
- One area of context Ofgem did not consider was the **role of NESO**, alongside the DNOs, as a major buyer of flexibility. Ensuring Flexibility Service Providers can stack revenue between the different markets and programs will help increase liquidity. Further incentivising NESO-DSO coordination will also help boost participation and liquidity.

2. What are your views on our overarching objective and proposed consumer outcomes?

We agree with the overarching objective - recognising that flexibility is a key way to deliver increased capacity. The current ED2 is already illustrating how using flexibility also reduces the overall cost of the network, and increases resilience.

Therefore, whilst the four proposed consumer outcomes are sensible, it is critical to ensure aspects across the four and the interrelationship between them is rewarded.

5. Do you agree that the incentives on DNOs will need to adapt from RIIO-ED2 and if so, how?

We recognise that incentives should evolve as market conditions and policy drivers evolve. Given the strategic importance of flexibility, we support a continuation of the current approach on totex which equalises incentives for capital and operating costs.

Based on our experience in Europe and the US, we have seen examples that unless DNOs are strongly incentivised to explore and develop flexibility as a non-wire solution, they will inevitably choose to focus on capital reinforcement. The latter approach is “business as usual”, with corporate memory and cultural bias meaning it is the path of least resistance. Flexibility is still, relatively, in its infancy as a concept and therefore DNOs need to see the financial rewards to justify investing time to build their own understanding even before they get to the stage of contracting and dispatching assets.

10. What is the potential availability of distribution-based flex across GB for DNOs in the short term and on the journey to net zero during ED3?

There is still untapped capacity available from distribution-based flex. The quoted figure in the consultation (of almost half of peak volume tendered being unmet) is the result of several factors, and should not be interpreted as lack of availability.

- Total revenue from DSO flex markets is modest as compared to other revenue sources - so potential FSPs will either not choose to participate or will prioritise other markets
- Inability to stack revenues further compounds the issue of FSPs having to choose between markets
- Variations between DSOs in terms of contracting etc also increases the burden with which a single FSP with assets across Britain can participate. Aspects of the ENA Open Networks efforts to standardise will help with some of this. The sector is also innovating to reduce barriers - for example the Piclo Max marketplace which enables FSPs to see and access the DSO local flexibility markets, as well as other revenue opportunities.
- Based on our experience of operating these local flexibility markets on behalf of the different DSOs as well as NESO, we can see that the larger aggregators and suppliers are still not fully entering the DSO markets; and smaller aggregators or asset owners are not willing to invest the time to develop bidding strategies based on the potential reward available. Again, one way to address this we believe is to make it easier to access multiple markets.

11. To what extent are global supply chain and workforce pressures contributing to longer lead times for delivery network reinforcement?

Most, if not all, developed countries are seeking to expand their electricity grids as they face the (welcome) common macro trend of a shift to electrification of demand. Therefore, Britain's networks will be competing against others for investment and for the supply of limited hardware.

For this reason, flexibility should continue to be a core part of ED3 - both in terms of minimising the cost of preparing the grid for future use, but also as it creates resiliency in terms of deliverability. More flexibility is a hedge against continued long lead times for equipment and workforce pressures.

Q14. What do you see as the role of distribution-based flexibility, both in the short and longer term, to manage distribution network constraints?

Q15. How do we ensure that network flexibility is used only when it is in consumers' long-term interests in ED3?

Consumers can currently be rewarded for their participation in network flex, which is also a useful revenue stream for aggregators. The revenue is available now, thereby creating a useful consumer proposition and incentive for those consumers to absorb at least some of the capital costs of switching to electrified demand. Therefore we do not agree with the statement that “network flex could be counterproductive”. A broader challenge is how to ensure both the network and system benefits of flexibility are fully recognised through the cumulative value and revenue that can be gained across different markets and services - which is currently not possible due to barriers to revenue stacking.

We agree with Ofgem that there is a strong use case of network flex in managing operational aspects.

Q20. Is a 5-year price control (2028-33) the right duration to achieve the objective of securing timely network capacity for the net zero transition at least cost to consumers over the long run?

We agree that, on balance, a 5-year price control is the right duration. It balances the need to give a period of certainty to the DNOs, albeit with reopeners, without locking in approaches which may need to evolve given the rapid change the energy system will face out to 2050.

Q39. What role should bespoke outputs and CVPs have in ED3?

We are supportive of the use of bespoke outputs in order to account for regional variations.

Q48. How should the price control encourage ongoing development of the DSO role and activities to optimise whole system benefits for existing and future consumers?

Q49. What should the role of the DSOs be in identifying and delivering whole system benefits?

We agree that DSOs evaluation frameworks should ensure that wider-system benefits are recognised - we anticipate that one outcome of this will be to underline the importance of revenue stacking to realise full value of flex for both network and system flex.

We do not believe that a flex-first approach for the purpose of deferring network investment is a false economy given the savings it has already delivered for consumers, whilst also enabling the networks to continue to invest grid reinforcement.

We would caution Ofgem against basing significant policy decisions on analysis (para 8.14) which is now nearly 4 years old (the Carbon Trust report) or which focusses on NESO-DSO coordination, of which there has been little significant progress despite its importance, and on which Ofgem's existing ED2 incentives appear to be lacking.