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By email: flexibilityconnections@ofgem.gov.uk

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Dear Chiara

**Enabling the competitive deployment of storage in a flexible energy system:
Changes to the electricity distribution licence**

Centrica supports the proposed clarifications to the electricity distribution licence set out in the statutory consultation. We suggest areas where more detail should be added to the draft Prohibition on Generating Guidance (POGG) at the end of this letter. However, the POGG is easy to read and understand and provides sufficient clarity on most points. We agree that the new licence conditions should take effect from 1 April 2019.

Whilst welcome, these changes to the electricity distribution licence are not sufficient to remove current and future conflicts of interest. We believe more action is needed.

We agree that the unbundling regime will need to be strengthened as the role of DNOs continues to evolve. This month's Smart Systems and Flexibility Plan Update set a priority action in for network companies to address potential conflicts of interest. Centrica is keen to engage in industry dialogue to find an optimum long-term solution.

In the shorter term, we believe Ofgem needs to end the licensees' ability to use their regulated network assets to provide commercial ancillary services to the Electricity System Operator (ESO). ENWL has bid into and been successful in recent FFR tenders. The potential exists for other DNOs to follow suit. The main associations¹ representing energy market participants wrote to Ofgem in August 2018 asking for the regulatory treatment of regulated assets providing ancillary services to be reviewed.

The POGG section on conflicts of interest (paragraphs 1.4 – 1.8) gives a very clear explanation of why there is the potential for competition to be distorted and new market entrants deterred when monopoly network operators carry out competitive

¹ Energy UK, with the support of the ADE, Renewable UK and the Solar Trade Association

activities. For the reader's convenience I have copied this section as an annex to this letter. POGG paragraph 1.5 exactly describes how the use of regulated DNO assets to provide competitive services is distorting the market. We therefore ask that Ofgem looks at aligning rules on the DNO use of network assets to provide flexibility services with the principles underlying these licence changes as a matter of urgency.

Detailed comments on the Prohibition on Generating Guidance (POGG)

<p>Criterion 1 <i>Reasonable steps to obtain a market-based solution</i></p>	<p>We support the intent of paragraphs 3.3 - 3.7, but these create a potential loophole where the licensee could claim that it has fulfilled Criterion 1 by carrying out any general or BAU procurement process for flexibility services that meet the requirements of 3.6 and 3.7.</p> <p>If the licensee carries out a procurement process to meet future flexibility needs “across the licensee’s network” and market participants do not come forward with the specific product/asset that the licensee claims it needs, then the licensee needs to run a subsequent process to allow the market to meet those more specific requirements.</p>
<p>Criterion 3 <i>Arrangements to minimise the risk of discrimination or distortion of markets</i></p>	<p>This section does not have any detail on how market distortions or discrimination risks will be managed. At a minimum 3.11 must contain an explicit prohibition on the licensee using any exempted asset to provide ancillary services to the Electricity System Operator (or to any other DNO) in competition with market participants.</p>
<p>Section 4 <i>Process for requesting a direction – paragraph 4.6</i></p>	<p>We believe Ofgem should consult stakeholders on all requests. Stakeholders need to be consulted to confirm that the relevant licensee took all reasonable steps to obtain a market-based solution. Stakeholders are best placed to identify the potential implications on the market of Ofgem issuing a direction.</p>

Thank you for the opportunity to respond to the consultation. I hope you have found this response useful. If you have any questions, please contact me on 07979 567785 or helen.stack@centrica.com.

Yours sincerely

Helen Stack
Regulatory Manager
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ANNEX - Draft Guidance: Prohibition on Generating Guidance – section on conflicts of interest

Conflicts of interest

1.4. Where competitive activities are carried out by monopoly network operators, there is the potential for competition to be distorted, for new market entrants to be deterred, and for investment in distribution networks to be affected. We believe the market for storage technology-based services is such an area.

1.5. Potential conflicts arise because distribution licensees control the physical infrastructure needed to trade energy and flexibility services. The provision of such competitive services, where provided by a licensee in an area of their network operations, has the potential to distort the market in two ways. Firstly, the licensee operating a generation asset to provide flexibility services may make use of its monopoly position in combination with access to lower cost of capital to compete against market participants, potentially undercutting them on price and thereby distorting competition. Secondly, licensees may have the ability to restrict the activities of market participants by denying (or impeding) their network access and preventing them from offering flexibility services in the first place. Regardless, any perception by market players who are considering investing in a generation asset that licensees operating a similar asset are in a position to potentially distort competition has the potential to negatively impact the development of a market for these competitive services.

1.6. Licensees' incentives to invest efficiently in the network can also be affected, if decisions are driven by shorter-term market signals, rather than longer-term investment signals. There can also be circumstances where the licensee has information about current and future flexibility service needs across its network not available to the wider market, which might give it an undue advantage in competitive activities. It is important that these risks are managed.

1.7. In the case of network-owned and operated storage, distortions or foreclosure have the potential to affect not just the uptake of storage by third party providers, but also the uptake of other forms of flexibility – such as DSR or flexible generators – that provide the same or similar services in the same markets. GB has a competitive market for aggregation of flexibility services that has the potential to deliver significant benefits to GB consumers by facilitating wider provision of flexibility services.

1.8. Our view is that over time – as the role of licensees continues to evolve and the potential for conflicts of interests increases – there will be a need for the unbundling regime to be strengthened to include separate ownership of assets with generation capability. This view is consistent with the direction of European rules on storage ownership laid out in the Clean Energy for all Europeans package.