

Legal Services

Northern Powergrid
Lloyds Court
78 Grey Street
Newcastle upon Tyne
NE1 6AF

tel 0191 223 5103

e-mail: john.elliott@northernpowergrid.com

Chiara Redaelli
Energy Systems Transition, Systems and Networks
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

26 October 2018

Dear Chiara

ENABLING THE COMPETITIVE DEPLOYMENT OF STORAGE IN A FLEXIBLE ENERGY SYSTEM: CHANGES TO THE ELECTRICITY DISTRIBUTION LICENCE

Further to your letter of 28 September 2018, I have set out below Northern Powergrid's comments in respect of the proposed licence modifications and the Prohibition on Generating Guidance.

We welcome the industry engagement that Ofgem has undertaken during the drafting of the proposed licence modifications. We believe it is critical that the views of all market participants are considered as this shift in policy will likely have a significant impact across industry and for our customers.

Summary

Our view is that the proposed changes:

- Introduce a barrier to whole system innovation because it precludes a licensee from including energy storage as part of an approved innovation project, which is inconsistent with Ofgem's commitment to innovation and the transition to DSO;
- Impose a one-size-fits-all compliance regime on licensees, which creates an unnecessary regulatory burden for those licensees that are not vertically integrated undertakings;
- Do not give licensees sufficiently clear guidance as to which projects are prohibited and which are not; and
- May prohibit licensees from deploying electric vehicles ("EVs") in the same way as any other company would in the normal course of business, which would be a perverse outcome.

Consequently, Ofgem should make the following changes in order to implement its policy decision and avoid the negative outcomes identified above:

NORTHERN POWERGRID

is the trading name of

Northern Powergrid (Northeast) Limited (Registered No: 2906593) and Northern Powergrid (Yorkshire) plc (Registered No: 4112320)

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne NE1 6AF. Registered in England and Wales.

If you would like an audio copy of this letter, a copy in large type, Braille or another language, please call 0800 169 7602

1. Amend the proposed licence modifications to allow the licensee to carry out generation/storage activities, which other entities are able to carry out in the normal course, in circumstances where the licensee is not acting in its capacity as a network operator;
2. Amend the draft Prohibition on Generating Guidance such that Ofgem will grant permission for any innovation project involving generation/storage brought to it by a licensee, provided that the innovation project concerned is subject to appropriate regulatory scrutiny and there are clear checks in place to ensure that it is not generating a financial return for the licensee; and
3. Either leave in place the existing disapplication notices regarding standard licence conditions 42 and 43 of the licences of licensees where those conditions are currently disapplied or issue a revised derogation to non-vertically integrated licensees, resulting in a more proportionate compliance regime.

Proposed licence modifications

- a) We note Ofgem's intention to reinstate standard licence conditions 42 and 43 in the licences of licensees where those conditions are currently disapplied. We believe this would be a mistake. Those conditions were originally included in the licence to address vertically integrated undertakings in the usual sense of the term i.e. groups that included distribution, larger scale generation and/or supply.

Making this change would introduce an unjustified regulatory burden on those licensees that do not have a Related Undertaking in their groups, are not engaged in larger scale generation and/or supply and, therefore, are not vertically integrated undertakings in that sense.

Consequently, we believe that the disapplication notices issued by Ofgem should continue to stand.

If Ofgem were to decide to reinstate standard licence conditions 42 and 43, we believe that it would be appropriate to do so in a way that makes it clear that the obligations contained in those conditions apply only to the matters on which the licensee will be required to report under the proposed standard licence condition 43B. In the event that Ofgem concludes from the reports provided or otherwise that the licensee may be carrying out activities that merit the reinstatement of standard licence conditions 42 and 43, it may take the appropriate action to do so. We have, therefore, attached suggested wording for an appropriate direction as Appendix 1;

- b) The drafting of proposed licence condition 43B.1 by reference to Section 4(1)(a) of the Electricity Act 1989 has the effect of prohibiting licensees from carrying out all generation activities.

However, in its letter dated 28 September 2018, Ofgem states that "While this [the proposed licence changes] will allow licensees to own generation (and therefore storage) assets for now, the new licence conditions would ensure that licensees cannot operate such assets themselves."

The proposed licence condition does not differentiate between the concept of ownership and operation. Consequently, Ofgem should amend the drafting so that it is clear the prohibition relates to the operation of generation assets only. We would, therefore, propose the following, revised drafting:

"43B.1 The licensee must not carry out the activity specified in Section 4(1)(a) of the Act, insofar as that activity relates to the operation of generation assets, except where the licensee:..."

- c) The exception contained in proposed standard licence condition 43B.1 (b) extends only to "assets, which are situated on sites on which the licensee carries out [the] Distribution Business". This drafting suggests that the exception excludes occasions on which the licensee may connect mobile generation to network assets that are located on land owned or occupied by third parties during power cuts.

As Ofgem has included Emergency Response in the Prohibition on Generating Guidance as a Category B exception, we would assume that Ofgem did not intend to limit the licensee's ability to operate mobile generation in the scenario noted above.

Consequently, we believe that proposed standard licence condition 43B.1 (b) would benefit from clarification in that respect. We would, therefore, propose the following, revised drafting:

- “(b) owns and operates assets for purposes of security of supply, system resilience, emergency response or energy management, always provided that the operation of such assets is within the normal activity of the Distribution Business (known as Category B exception); or”;
- d) Proposed standard licence condition 43B.7 has the effect of making any obligation contained in the Prohibition on Generating Guidance (and in any future version of it) a licence obligation. We believe that such an approach circumvents the licensee’s ability to lodge an appeal against a licence modification and, therefore, this proposed condition should be deleted. If Ofgem wishes to introduce additional obligations into the licence, it should do so via the usual licence modification mechanism; and
- e) In circumstances where the licensee is not acting in its capacity as a network operator, the proposed arrangements will prevent the licensee from carrying out generation/storage activities, which other entities are able to carry out in the normal course. An example would be a future scenario where users of EV are able to trade any residual charge those EVs may have. The prohibition would, therefore, be a disproportionate consequence in such cases, given the small amounts of storage that would be involved.

Prohibition on Generating Guidance

- a) We note Ofgem’s evolving policy position on changes to enable the further deployment of storage and, although we agree with enabling the deployment of the technology in a competitive manner, we have serious concerns regarding the extent of the proposed changes and, consequently, the disproportionate limitations that are being placed on licensees.
- b) We believe that, as a result of the proposed changes, a fair and competitive market will be unable to form and fewer competitive projects will be delivered to the market. We support fair and proportionate measures being applied to all market participants that will facilitate competitive development of innovative solutions.
- c) Ofgem states it does not believe the proposed changes will stand in the way of future innovation projects in the distribution sector as there is little to be gained from such projects where the business models are not reflective of the emerging policy landscape. We strongly disagree with this stance as there is clear evidence to show that licensees have been at the forefront of developing innovative solutions in recent years. Removing any form of incentive to do so would likely limit the future deployment of such solutions. Ofgem is, therefore, introducing a barrier to whole energy system innovation by requiring any exporting generation to be supplied by the market rather than small-scale trials being conducted by licensees to prove concepts prior to larger scale roll-out.
- d) Given the diverse range of storage solutions that are being brought to market, it is critical that the guidance is clear and can be applied easily to specific types of storage. We believe that the guidance fails to provide the required level of clarity, particularly around the future deployment of smart charging of EVs which, in turn, creates uncertainty when looking to apply the guidance to existing and future projects.

We expand on the above comments in appendix 2.

Yours sincerely



John Elliott
Head of Regulatory Compliance

Suggested Direction Wording

Direction in respect of Standard Licence Condition 42 (Independence of the Distribution Business and Restricted Use of Confidential Information) and Standard Licence Condition 43 (Appointment of Compliance Officer) of the Electricity Distribution Licence issued to [Licensee name] by the Gas and Electricity Markets Authority

1. This Direction is issued by the Gas and Electricity Markets Authority (the “Authority”) in respect of standard licence condition (“SLC”) 42 and SLC 43 of the Electricity Distribution Licence (the “Licence”), treated as granted under section 6(1)(c) of the Electricity Act 1989 (the “Act”), to [Licensee name] (the “Licensee”).
2. We direct that:
 - a) SLC 42 shall not have effect in the Licensee’s Licence;
 - b) Paragraphs 43.1 to 43.5 inclusive of SLC 43 shall not have effect in the Licensee’s Licence; and
 - c) Paragraphs 43.6 to 43.12 of the Licensee’s Licence shall read as follows:

Licensee’s own Compliance Report

- 43.6 The licensee must produce an annual report (“the Compliance Report”) about its compliance during the relevant year with the Relevant Requirements.
- 43.7 The Compliance Report produced in accordance with paragraph 43.6 must, in particular, do the things described in paragraphs 43.8 to 43.10.
- 43.8 Not used.
- 43.9 It must refer to such matters as are or may be appropriate in relation to the licensee’s compliance with the Relevant Requirements.
- 43.10 It must set out the details of any investigations conducted by the licensee, including:
 - (a) the number, type, and source of the complaints or representations on which those investigations were based;
 - (b) the outcome of the investigations; and
 - (c) any remedial action taken by the licensee following them.

Publication of Compliance Report

- 43.11 The licensee must:
 - (a) provide the Authority a copy of every Compliance Report in accordance with the Regulatory Instructions & Guidance (RIGs) document issued under standard condition 46 (Regulatory Instructions and Guidance); and
 - (b) publish each such report on, and in a way that is readily accessible from, its Website (if it has one).

Interpretation

43.12 For the purposes of this condition, **Relevant Requirements** means the requirements of standard condition 43B (Prohibition on Generating by Licensee).

This Direction shall have effect from and including 1 April 2019 and shall remain in effect until such time as we revoke or vary the Direction in writing upon reasonable notice.

Dated:

Comments on the Prohibition on Generating Guidance

Stifling Innovation

Ofgem has stated that its policy direction does not stand in the way of future innovation in the distribution sector. As recent developer of distribution innovation projects, we would, however, disagree.

The history of innovation projects in respect of storage in this country suggests that leadership of such projects by licensees has significantly benefited the pace of development and the introduction of competitive services. There may still be an incentive to invest in projects that understand the impact of low carbon technologies, storage and flexibility and those that address safety, resilience or reliability. However, this may require other parties to be involved or the licensees to go through more complex approval processes. This extra complexity introduces a barrier to that innovation.

We are supportive of appropriately implemented regulatory oversight of ownership and operation of storage by licensees. However, the scale of innovation projects that have been developed in the sector to date would suggest that it is unnecessary for such stringent controls to be applied to such projects as they are typically in the kW/low MW range and, therefore, do not pose a risk of distorting the market, which is Ofgem's key concern.

As these projects have proven in the past to introduce technologies into new markets and deliver customer benefits, we believe that regulatory policy needs to continue to encourage such innovation so that successful projects can then be rolled out on a larger scale.

As an example, we are developing innovation projects on increasing system resilience for our rural and our electricity dependent customers i.e. where power cuts are either more frequent or the customers affected find them harder to deal with. We are seeking to explore future business models where there is an element of storage in the system that assists with resilience and where income from trading could help to finance that investment. Ofgem's direction of travel means that this storage (even at small scale in an innovation project) would need to be provided by another party at the outset (regardless of its materiality) so introducing barriers to whole system innovation.

We believe that innovation projects should be exempt from the prohibition, provided that they are subject to appropriate regulatory scrutiny and there are clear checks in place to ensure that activity is not generating financial returns for the licensee. If this is not achievable, for whatever reason, the exception criteria should be proportionate to a project (kW/MW) or a de-minimis threshold set.

Electric Vehicles

Due to the complexity of the arrangements, Ofgem must be explicitly clear both on the definitions contained within the guidance as well as on the criteria specific projects must meet in order for them to be permissible.

If Ofgem is not minded to allow licensees to undertake activity in the ordinary course of business, we believe the guidance should provide further clarity over the deployment of EVs in particular and the manner in which the smart charging of EVs can be implemented by licensees. This uncertainty stems from the fact that the term 'smart charging' is often grouped under 'flexibility services', so charging an EV with a smart charger could be defined as providing a flexibility service. Under this scenario, the licensee would not be compliant with the requirements set out in paragraph 2.14 in the guidance because, under this definition, the secondary purpose of charging the EV would be to provide a flexibility service. Without a clear distinction between operations that involve EVs and other means of storage, it is questionable as to how licensees could remain compliant with the proposed guidance.

We would suggest that the guidance reflects the difference between EVs and conventional forms of storage to avoid the ambiguity over how smart charging could fall within the guidance. In this way, licensees may decarbonise their fleets in the same way as other companies, so lowering carbon footprint and minimising costs.