



BY EMAIL ONLY

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Our reference: ONPID19

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15th October 2019

Position paper on Distribution System Operation: Ofgem's approach and regulatory principles

Dear Louise,

thank you for providing us with the opportunity to comment on the above Ofgem position paper.

Please find our comments attached

Yours sincerely,

Kate Garth

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1) Do you agree with our strategic outcomes?

Ofgem's DSO reforms are designed to deliver the following four strategic outcomes:

- *Clear boundaries and effective conflict mitigation between monopolies and markets*
- *Effective competition for balancing and ancillary services, and other markets*
- *Neutral tendering of network management and reinforcement requirements, with a level playing field between traditional and alternative solutions.*
- *Strongly embedded whole electricity system outcomes.*

We agree with the intent to deliver the above 4 strategic options and would emphasise the overarching need to ensure that delivering clear boundaries between the activities of regulated DNO monopolies and market participants, helping to avoid and real or perceived conflict of interest.

We believe it would be helpful for Ofgem to set out clear timescales for the delivery of these strategic outcomes and the interim steps required to deliver them, otherwise the risk remains that they will not be achieved.

2) Do you agree that our work programme will help to deliver the strategic outcomes?

No, we do not.

The three workstreams highlighted within the position paper:

- DNOs and new contestable services
- Key enablers for DSO functions
- and Development of coordinated flexibility markets

do not appear represent a step change to the current uncertainty within the market and do not set any clear objectives or timescales in terms of delivery. We believe this will both undermine Ofgem's ability to achieve its wider strategic outcomes and will prevent a fully functioning market for flexibility being delivered that delivers decarbonisation at least cost.

DNOs and new contestable services

We are concerned at the lack of progress in terms of clarifying and confirming the appropriate role (and breadth of that role) for DNOs to provide contestable services. We remain concerned that decisions whether to allow DNOs to provide services for which market substitutes exist, remain outstanding (we note the position paper cites the issue of allowing DNOs the capability to modulate EV chargers and the issue of CLASS – the decision we note is not intended to be taken until after a consultation in H120).

We noted the information included in Appendix 1 Programme of work – DNOs and Contestable Services; and would highlight that the 3 high-level characteristics associated with DNOs participating in contesta-

ble services (*vertical integration, unique monopoly position conferring competitive advantage and conflict between competitive role and neutral monopoly role*), clearly illustrate the actual and perceived risks without any significant (and demonstrable) benefits being provided.

We remain very concerned that the lack of a decision both on whether DNOs should be allowed to participate in contestable markets (including providing commercial services to the ESO) and to what extent without having determined how separation of the DSO and DNO functions could and should be managed will lead to further ambiguity and further reduce investment by commercial participants into flexible services, risking a self-fulfilling prophecy.

The expected milestones set out in Figure 3 relating to DNOs and new contestable services to be delivered by industry include:

2019	2020	2021-2023
DNOs to develop and demonstrate mitigation to real or perceived conflicts of interest	Stakeholders to provide input into discussion around DNO involvement in contestable services	DNO's plans in RIIO-ED2 should take account of DSO contestable policy

The expected milestones set out in Figure 4, relating to milestones set out in the position paper document relating to DNOs and new contestable services

2019	2020	2021 - 2023	
Decision on DNOs' capability to modulate EV chargers	Consult on the treatment of CLASS in RIIO-ED2	Develop clearer view on DNOs' role in flexibility market platforms	Consider broader policy positions on DNO participation in new contestable services

We are particularly concerned regarding the last milestone in figure 4, which appears to be set out from a position of allowing DNO participation, whereas; (given it is easier to maintain the status quo) we believe this should be set out from a position that DNOs should not participate (to overcome any institutional bias or inertia). DNOs should therefore have to provide demonstrable reasons why they should in future be allowed to participate in the competitive, market based contestable market. Given the timings of the 2 preceding decisions:

- in 2019 for the modulation of EV chargers,
- and 2020 on CLASS,

we are concerned that a precedent may have already been set (which could also undermine or disincentivise engagement with the Industry led discussion of DNO involvement, as set out in Figure 3). This could negatively impact a proper consideration of these policy positions.

We have previously raised our concerns regarding the decision to allow a DNO owned assets to compete within the competitive market; most recently in our response to the Open Networks Future World consultation, submitted May 2019:

“The functionality developed under projects such as CLASS is welcomed but should only ever be used as a last-resort in the event of an OC6 Demand Control instruction. Any use of DNO-owned assets in markets introduces the risk that development of DER for Ancillary Services will slow/cease as the DNO provider’s return in investment model differs massively from any other asset owner. Permitting their use will ultimately mean that Ofgem and the ESO have “too many eggs in one basket” in the event of a major OC6 event i.e. in the event of a major disruption where would the response / reserve come from if the capacity provided by the markets are unable to compete with subsidised DNO assets?”

We recognise Ofgem’s determination to embed optionality within the development of DSO functions and agree this will be very important. However, we are concerned at the more caveated approach set out in the position paper, which states:

*1.14 - DSO functions continue to evolve. We recognise this, and believe it is in the interest of energy consumers to maintain policy optionality in this area for different institutional arrangements in future. This mitigate risk that sub-optimal solutions are adopted now that are then difficult to change later once the changing system is more mature. **We will work with existing and new institutions to ensure they do not absorb new DSO functions to the degree that they cannot be unbundled in future. Interoperability of system architecture and ring-fencing of functions help ensure future optionality is not lost.***

We would flag our ongoing concern regarding this approach (and assumption) that the future DSO as the neutral market facilitator will almost certainly evolve from the current DNO (given the likelihood of future unbundling). [We would note that that assumption was explicit in the 2018 ENA consultation into the Future Worlds, which stated:” *The transition of DNO functionalities to DSOs will continue in all the Worlds considered*”¹]. In this case, we would seek greater assurance from Ofgem there will be an explicit requirement to deliver the interoperability of system architecture and ring fencing of functions, and soon - to avoid the risk of any unnecessary costs and or delays.

We remain concerned there is an implicit assumption or at least expectation that DNOs will absorb DSO functions and be considered as such, without neither explicit regulations nor licence conditions to explicitly govern their behaviour and / or their current / future remit. This would include avoiding the real or perceived conflicts of interest associated with being both the procurer and provider of services.

Key enablers for DSO functions

We agree with the enablers stated in para. 3.8:

- *Forecasting and planning enablers*
- *Network monitoring and visibility enablers*
- *Flexibility trading enablers*
- *Flexibility dispatch and control enablers*
- *Data exchange enablers*

¹ [http://www.energynetworks.org/assets/files/14969 ENA FutureWorlds AW06 INT.pdf](http://www.energynetworks.org/assets/files/14969_ENA_FutureWorlds_AW06_INT.pdf)

However, we are concerned at the timings associated with these enablers, (as contained in Figure 3) as the document suggests these milestones are expected to be delivered by industry. We would like greater confirmation that they will be delivered and how Ofgem intend to monitor and publish updates towards achieving those milestones for industry and other stakeholders. Our concern is that the milestones set out in Figure 3 will be delivered through the Open Networks Project, which is not always the most transparent or easy to access and often delivers limited stakeholder input.

For example, we note the noted milestone (in Figure 3) for DNOs to *“develop and demonstrate mitigation to real or perceived conflicts of interest”* in 2019. We recognise and welcome the work and effort being done under the Open Networks Project WS3, Product 7 which provides a log of issues defined as Conflict of Interest and or Unintended consequences to ensure these issues are considered and solutions found.

However, we would note that as at 8th October 2019, there are currently 9 conflicts of interest listed on the log (of which 5 are open) and 29 unintended consequences (of which 26 remain open). It is also worth noting that whilst 5 mitigation solutions have been started, there is no means to evaluate the extent to which these have been deployed successfully or whether the identified issue has been fully resolved.

We would also note several concerns relating to this workstream including the statement in paras 1.24 & 1.25 (appendix 1) which states:

“1.24 Industry’s work, such as within the ENA’s Open Networks project has shown that the application of key enablers for DSO functions are maturing; and roll out should be adopted. Decisions that are made now on these enablers have the potential to cause policy repercussions for the future. For example, if poorly applied they could narrow policy options by locking in a DSO function to a party so that it cannot be contested; potentially raising the cost and time required to transition to a smart energy system. Therefore, there is an important role for Ofgem to ensure policies support the most appropriate roll out of key enablers for DSO”

1.25 To be clear, the development of enablers is for industry; our role is to create a policy environment in which enablers can be progressed and DSO delivered in line with our strategic outcomes.”

We would be concerned if the policy environment were not sufficiently clear or robust, that it enabled industry could develop sub-optimal options, without fear of regulatory intervention at an early stage.

The stated results of the analysis shown in paragraphs 1.31 – 1.34 suggest there is already a risk of this occurring, given the Ofgem statements, such as:

“1.32 From our analysis, we can see a significant gap between trialled and current business as usual practices. This discrepancy highlights the need for us [Ofgem] to steer the adoption of key enablers for DSO functions.”

1.33 “There is a risk of DNO-led path dependence if DNOs seek to secure new DSO functions and services, and in so doing inadvertently or otherwise remove the possibility for another party to undertake these”.

We are concerned that the language used in para 1.34 suggests a less than robust approach is currently being used:

“encourage the network companies to focus on interoperable technologies, making their metadata visible, pursuing a presumed open approach to data...” and “We expect care to be taken in the development of the DSO function so that this does not lead to inadvertent or deliberate foreclosure of new markets for DSO function delivery”.

This concern seems well placed, given the summary conclusions contained in para 1.45 which states:

“We consider that currently the most important key enablers for DSO functions are forecasting and planning data, and enhanced network visibility. We expect companies to be taking ownership of making improvements in this area.”

Given that there appears to not be any corresponding milestones to address this in either Figure 3 or Figure 4, we would seek confirmation from Ofgem that these issues are being acknowledged by the DNO and that greater monitoring, oversight and implementation of improvements are being tracked by Ofgem, and where there are still gaps, that these will be addressed in the near term with explicit regulatory requirements and or sanctions, rather than allowing the situation to continue.

Development of coordinated flexibility markets

We agree with the need for coordinated flexibility markets that better enable market participants to stack revenues and compete with the DNO to provide alternative solutions to network reinforcement / new assets. We recognise and applaud the work done by ENA (including its flexibility page) to set out what, when and where flexibility is being / or will be procured.

Whilst we note the latest figures on the ENA website relate to July, we would hope that further flexible generation and demand is contracted in 2019 to meet the forecast volumes and if not, that further work is undertaken to understand (and where necessary) mitigate why lower than anticipated volumes have been contracted²:

	Market-based Flexible Demand (MW)	Market-based Flexible Generation (MW)
Industry Total - End of 2018	51.9	209.8
Industry Total - Projections for 2019	358.8	588.6
Contracted July 2019	12.6	30.1
Industry Total - Contracted to Date	64.4	239.9

² <http://www.energynetworks.org/electricity/futures/flexibility-in-great-britain.html>

3) Do you have anything to add to the thinking and analysis that informs how we propose to deliver our programme of work?

We would welcome the opportunity to participate in the proposed workshop to discuss developments in DNO flexibility tenders due to take place this autumn.

We would welcome more visibility on when and how Ofgem intends to act, should the milestones as set out in Figures 3 and 4 are not on time (or delivered to the required standards).