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Solihull, 15<sup>th</sup> October 2019

### **Sembcorp feedback to Ofgem's paper on Distribution System Operation**

Dear Louise and Flexibility and Whole System Coordination Team,

Many thanks for offering the possibility to comment and provide feedback to your position paper on Distribution System Operation.

This paper comes at a topical moment as industry have been witnessing a series of developments in electricity markets which have had serious consequences on displacing competition and on investment confidence.

We welcome this thought piece from Ofgem and are very pleased that the Regulator has taken into account some of the previous feedback and concerns that Sembcorp had shared with your team. The paper clearly shows that the Ofgem has been considering the issues that are worrying market participants and we hope that these will be addressed as quickly as possible.

While we praise Ofgem's ambitions and the holistic approach shown in the paper, Sembcorp still holds some concerns on the action plan necessary to address the concerns of industry. We believe that the paper is not offering a tangible and timely progress to address the critical issues emerging around the evolving roles and responsibilities of DNOs and market participants.

We have offered substantial evidence<sup>1</sup> on the detrimental effects to competition of regulated monopolies participating in competitive Ancillary Services markets, including concerns over the actual anticipated benefit to consumers.

We strongly urge Ofgem to launch a consultation, gathering views from industry on the topic, ahead of the intended review of the DRS8 direction. This is crucial and should be addressed and properly consulted on as soon as possible, before 2020.

Market participation utilising regulated assets carries high risks of market distortion. Business models based upon competition and incorporating revenue from Ancillary Services are not based on the expectation of competing with regulated monopolies and will continue to be heavily impacted if DNO participation continues in any form. Where DNOs become active market participants, these markets are no longer truly competitive. This could impact on system security by taking market share away from merchant participants which will in turn reduce the number of

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<sup>1</sup> Our letter to Jonathan Brearley of 1<sup>st</sup> July 2019.



active market participants. Further negative impact is also to be anticipated in the incentives for DNOs to invest efficiently in their networks.

It is in the interests of all consumers to ensure the development of truly competitive markets for flexibility, and to date we are not confident that this will be delivered in a timely manner.

In the following pages, we respond directly to the questions posed by Ofgem.

As always, I would be happy to continue our discussion and offer further clarification in a meeting.

Kind regards,

Alessandra De Zottis  
Regulatory Affairs Manager  
Sembcorp Energy UK

## Response to questions

### 1. Do you agree with our strategic outcomes?

Sembcorp agrees with Ofgem's strategic outcomes. We encourage Ofgem to provide a strong and clear direction on the responsibilities of the different entities and participating parties in distribution system operation.

#### Clear boundaries and effective mitigation between monopolies and markets

We support the intention to set clear boundaries and responsibilities between monopolies and market participants. This should take stock of Ofgem's previous positioning according to which where competitive activities are carried out by monopoly networks operators, there's a risk for their incentives to invest effectively in their networks to be affected.

Sembcorp has provided evidence on the fact that ENWL participating in Fast Reserve and Firm Frequency Response services, in direct competition with competitive providers, had undercut the market and severely undermined the investment case for flexible assets. The lack of consultation over the decision to allow a regulated monopoly to recover uncapped revenues in competitive markets has led the DNO to take advantage of the general lack of clarity and direction from Ofgem on the boundaries between monopolies and markets, resulting in an unprecedented crowd-out effect and deterioration of market confidence.

#### Effective competition for ancillary services and other markets

Effective competition is key in this work stream and we encourage Ofgem to consider this element not just in the short-term but also in the longer term. As we said previously, Ofgem should be questioning whether DNOs, and in the future DSOs, as regulated monopolies are truly fulfilling the role of neutral market facilitators and whether competition is actually sustainable, i.e. is competition driving real value for consumers? Simply sharing the benefits by lowering consumer bills should not be considered a sufficient indication of consumers' benefit, as there are several other aspects that might be less evident but that ultimately have negative repercussions on the end consumers. We urge Ofgem to refer to our letter to Jonathan Brearley of 1<sup>st</sup> July 2019 for more details.

#### Neutral tendering of network management and reinforcement requirements, with a level playing field between traditional and alternative sources

We support this key strategic outcome. In particular, we urge Ofgem to consider the risk that when DNOs are allowed to be in direct competition with market participants, a conflict of interests automatically emerges on the distribution connection agreements. We have reasons to believe that DNOs will have no incentive to give connection offers to flexibility providers that would be in direct competition with them. This situation has to be avoided at all costs.

It is vital to ensure that networks are not in competition with those that could wish to connect to their network, whether through market mechanisms or otherwise. A number of potential conflicts exist when this is the case and these must be entirely mitigated before industry can hold confidence in the neutrality of DNOs performing DSO functions including tendering for flexibility.

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

While we praise Ofgem's ambitions and the holistic approach shown in the paper, Sembcorp still holds some concerns on the action plan necessary to address the concerns of industry. We believe that the paper is not offering a tangible and timely progress to address the critical issues emerging around the evolving roles and responsibilities of DNOs and market participants.

We do not think that the workplan set out in this position paper is sufficient to deliver the strategic outcomes set out in this document as well as in the wider Smart Systems and Flexibility Plan. Following our engagement with Ofgem individually and via Energy UK, we were hoping to see an ambitious work plan that would concretely address the severe issues we flagged in several occasions.

Sembcorp is urging the Regulator to immediately review and revoke their DRS8 decision and consultation cannot wait until 2020. The unprecedented negative effects need to be addressed with urgency.

#### DNOs and new contestable services

We welcome the intention to ensure that decisions made on DNOs and contestable services are consistent and coherent. This should have already been the case when Ofgem made the decision to allow CLASS technology to participate in competitive markets and to allow a regulated monopoly to recover uncapped revenues using technologies that have already been paid for by consumers.

In addition to this direction not being in line with the process set out in this position paper, and not reflecting Ofgem's past positioning, industry is yet to receive an indication from Ofgem as to why that decision has not been reversed yet, and why ENWL was not asked to provide an impact assessment of the actual impacts to consumers and to the market.

The lack of immediate action from Ofgem to address the detrimental impact on the market is exacerbating the issue of ENWL vastly undercutting competitors in FR and FFR markets to the point of holding a monopoly position and effectively collapsing the case for investment. This was allowed without any full and open consultation process. While industry has provided evidence on how CLASS technology in competitive markets is not delivering the range of consumers benefits initially expected, Ofgem should now take stock of the information and request a full impact assessment from ENWL.

The lack of consultation and explanation as to how Ofgem had reached the decision to allow ENWL to participate in competitive markets and the delay in separating regulated monopolies from competitive markets, following continued and consistent requests from industry, has further eroded confidence in Ofgem's actual commitment to deliver under this workstream.

#### Key enablers for DSO functions

Sembcorp welcomes the commitment to set the basis for better system and network data visibility. The open letter from BEIS and Ofgem to the ENA on the need to progress with more concrete deliverables is a positive step in this direction and is sending a strong message to DNOs to be ambitious in opening and improving the data of capacity connected at distribution level. We also welcome Ofgem's involvement in DCUSA modification proposal DCP350, which aims at establishing an Embedded Capacity Register. Increased visibility and better understanding of the data will also support the delivery of the Energy Data Task Force recommendation of enabling operational data to be layered across the assets to support system optimisation and facilitating multiple actors to participate at all levels



across the system. In this way, a wider range of participants will be able to develop their own approach to DSO functions.

#### Development of coordinated flexibility markets

We welcome this work stream and encourage Ofgem to hold DNOs to account on the actual progress of this deliverable.

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

Sembcorp cannot stress enough the need to urgently address the problem of ENWL participating in competitive markets. The level of urgency is dictated not only by the latest negative effects on competition but also by the need to ensure there is a strong basis in place to deliver Ofgem and BEIS' commitment in the Smart System and Flexibility Plan: i.e. to deliver effective market mechanisms and developing mature markets for flexibility in the early 2020s.

The progress to date does not give the confidence that we are on track to deliver on these ambitions and we call for a revised assessment of the elements covered in this position paper that the whole industry regard as urgent.