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Head of Flexibility and Whole System Coordination
Ofgem
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London, E14 4PU

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Dear Louise,

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

Scottish and Southern Electricity Networks (SSEN) welcomes the above position paper and the opportunity to feedback on Ofgem's proposed approach and the outcomes it is seeking to achieve.

We have first-hand experience of the value of flexibility on the distribution network. Long established measures have already been proven to deliver benefits to customers and provide valuable learning e.g. Time of Use Tariffs, such as Economy 7, and the Radio Tele-Switching (RTS) system have been in operation for more than twenty years and remain critical to managing network capacity by shifting significant domestic electric heating load to off-peak periods. More recent developments such as flexible connections and ANM have also been shown to deliver significant benefits. Analysis led by SSEN and EA Technology estimated that if RTS-controlled electric heating load reverted back to the evening peak in our SHEPD network area, it would cost customers £160m to build the extra generation and network capacity.

DNOs are best-placed to deliver DSO

There is no doubt that this transition requires a targeted effort from all, including regulators, Government, innovators and utilities to stimulate interest and create the propositions that will provide DSOs and the ESO with the flexible services needed to deliver economic and environmental benefits. We absolutely accept that there is also a role for others in this market. Indeed, we have been actively working and engaging directly with new operators providing market platforms and peer-to-peer platforms and new service providers with the view to developing their offerings.

However, we believe DNOs are best-placed to deliver the majority of DSO functions outlined by Ofgem. DNOs are already making this transition through their commitment to the ENA Open Networks Project. The resource, investment and intellect dedicated to recognising and working through the challenges of how to facilitate this transition and make it work, are testimony to this. As are the collaborative commitments that DNOs have publicly made, not least their commitment to *“creating a smarter, more flexible and more efficient energy system, whilst continuing to provide safe, reliable, affordable energy supply to all”*.

A successful transition demands a coordinated approach, with clarity around accountabilities and responsibilities to ensure outcomes are delivered. It needs parties that are committed to the long-term success of that network – both in terms of its physical and operational aspects, and to the delivery of an efficient, holistic whole system. We are mindful of efforts elsewhere, for example, the introduction of competition in metering in 2006, which created a fragmented marketplace and loss of clarity for market participants and users.

We believe the DSO roles of system planning, moving towards real-time operation and the development of the commercial framework, are a natural extension of our existing DNO role, and that – with more transparency and the right regulatory framework to drive and support these behaviours - we can deliver the efficiencies of coherent investment planning, taking into account flexibility, optionality, condition and capacity-based investment.

It is key that we avoid falling into the trap of underestimating the interdependence with the functions performed by a DNO and assuming that others, without the experience or commitment to the success of the networks and their consumers, are any better placed. Our experiences on Shetland through our competitive tender process, and on the mainland through our Constraint Managed Zone initiative, are testament to the real-life challenges that emerge when engaging other parties. What is more, solutions need to be capable of, not only delivering during routine days, but also during exceptional events, such as storms.

DNOs are delivering progress

As acknowledged in Ofgem’s position paper, progress is being made towards Ofgem and BEIS’ flexibility plan. As Ofgem knows, we are already actively engaged in facilitating markets and alternative solutions through our work to develop Constraint Managed Zones, Active Network Management schemes and innovation and demonstration projects (including Transition and our Low Energy Oxfordshire (LEO) project), and we are taking the learning from these to inform both our own and industry’s next steps. This is in line with Ofgem’s expectation that DNOs should take on and neutrally facilitate network and system needs now. There should, therefore, be no doubt over our commitment to finding new ways of working and doing the right thing.

Furthermore, the UK has set some admirable and challenging goals for Net Zero; goals which we as a company are committed to.

Our asks of Ofgem

Ofgem has a key role in the energy system transition. Whilst we absolutely understand the merits of optionality and the role that this has in the evolution of the energy system, too much optionality can create uncertainty and a reticence to commit. Ofgem needs to give DNOs certainty over their role going forward.

We support the output of Baringa's analysis - World B - and we believe Ofgem should, at least for the purposes of RIIO-ED1 and RIIO-ED2 timescales, commit to a regulatory framework that is consistent with this. This would provide much-needed clarity for network operators in preparing their RIIO-ED2 Business Plans and to put in place the systems, contracts and / or mechanisms necessary to bring about the transition. We believe it would also make RIIO-ED2 a more manageable task.

We absolutely understand the drive to reduce costs; this is not new. Successive price control frameworks have consistently sought to drive efficiencies. However, there are costs in maintaining and operating the existing network and there are costs in providing the information and analysis that is now needed to ensure and demonstrate that we continue to invest and manage our network so that it can cope with the challenges of Decarbonisation, Decentralisation, Digitalisation and Democratisation. It is irresponsible to mislead consumers about the future costs of our energy system and unrealistic to expect more to now be delivered for less. Of course, there will be opportunities to do things more efficiently, or to do things differently, but this is not without cost and if we want a leading energy network, we believe we need to be honest with stakeholders and reflect this in a fair and realistic RIIO-ED2 settlement.

More pressing is the fact that in RIIO-ED1, DNOs are already engaging in DSO-type roles and dedicating resources to the challenges around, for example, data transparency, assessing network options and more granular network monitoring. It is not appropriate to expect DNOs to continue to deliver this without: (a) fully understanding the costs; and (b) an appropriate mechanism to allow recompense. This is not the only area where the boundaries of the RIIO-ED1 settlement are being pushed; we are mindful of pending licence conditions around whole-system obligations and proposals to require potentially onerous independent auditing in relation to asset data.



For the avoidance of doubt, we support the direction of travel and much of what is set out in Ofgem's DSO position paper. We are entering a period of change where we, as a networks business, have a key role in investing to support the future energy system and the UK's climate change ambitions. It is therefore an incredibly exciting time and our comments here are meant to ensure that ambitions are realised.

Should you wish to discuss any aspect of this response, please do not hesitate to contact me. We would be only too happy to engage further with you on this.

Yours sincerely,

Gill Hilton
Networks Regulation.

ANNEX

1. Do you agree with our strategic outcomes?

We agree that Ofgem has identified a good set of strategic outcomes. However, we would make the following specific observations.

The important role for monopolies in providing consumer safeguards during the transition

Clear boundaries are important to ensure that parties know where opportunities and accountabilities exist.

Whilst SSEN recognises that markets have a significant role to play in the new decentralised system, it is important to recognise that markets bring their own set of challenges. For example, in terms of assigning accountability and ensuring that parties have the necessary drivers to safeguard the interests of consumers. Importantly, the framework needs to deliver not only under 'routine' circumstances, but also during exceptional events. It also needs to deliver in timescales that fit with consumer need. We are mindful of our own experiences on Shetland, where we have been involved in a long and drawn out process to try to identify the optimum competitive solution.

Moreover, there are costs in testing the market and assessing options and whilst this will uncover savings in some areas, for others this will add to current costs. In commercially unattractive sections of the market where the market is particularly illiquid, market solutions are likely to prove an expensive option. In very specific geographically bound areas (as can be the case with network constraints), the illiquid nature of markets can make them subject to gaming and instability.

We also believe that from a social perspective markets can, if not managed, result in the exclusion of large parts of society whether through technical (e.g. no broadband), economic (e.g. no capital) or social (e.g. disability) restrictions. Experience of broadband roll out in the UK has shown that markets may fail to service all communities.

Given the above, we believe it is key that Ofgem, Government and industry are both realistic and transparent with consumers about these challenges and, in order to provide protections for all consumers, options for regulated deployment are retained while markets are developed and tested. Whilst we would not typically support this 'supplier of last resort'-type approach, we believe consumers need and deserve this safeguard. Whilst markets are developing, we believe monopolies have a vital role to play where they can help to mitigate costs and / or maintain service standards to consumers that may otherwise be left behind.

However, in so doing, monopolies must be appropriately recompensed, and the regulatory framework must adequately acknowledge the premium in providing this role.

Conflict mitigation

As noted above, we believe it is key that the role of monopolies and their role in terms of providing for all consumers is not undermined. To this end, we are committed to demonstrating neutrality.

Examples such as “CLASS” have been central to discussions around neutrality. Whilst it is our view at this stage that DNOs should not be allowed to bid network assets directly into the market, we recognise that it may be in customers’ interest for network assets to provide, for example, technical services. We therefore believe that the discussion should be focused on how and where DNOs can assist and how the costs of providing these services / functions as an integral part of the efficient operation of the system can be recovered.

Importantly, this must not undermine the development of the competitive market and therefore where DNOs are identified as being best-placed to deliver a service or function – and this might be location-specific – we believe this should be carved out of the competitive market and subject to appropriate regulatory funding arrangements. Transparency around this is key. It may be that these arrangements are subject to review every set number of years to establish whether DNOs are still best-placed to deliver these services or functions, or whether innovations or a more liquid marketplace mean that other providers are now better-placed to step in.

Basis for assessment

Establishing a level playing field between traditional and alternative solutions is highly dependent on the timescales over which options are assessed and the extent to which other parameters are considered. A shorter timescale will tend to favour alternative, more flexible solutions and result in less network reinforcement; whilst a longer timescale may start to favour network reinforcement.

We absolutely see the role for flexible, alternative solutions, especially in managing the uncertainty in transitioning to a more decarbonised, decentralised energy system. However, flexible, alternative solutions are just part of the solution going forward and will not, on their own, address the challenges that the network is facing.

It must be recognised that network investment is vital; even more so when we consider the potential average age of cables and secondary substations in the UK by 2050 if we continually defer replacement. If, based on standard asset lives, we should be replacing the majority of

the network as a result of condition by 2050 then we should build this consideration in to our cost benefit assessments of flexibility and the enablement of low carbon technology growth.

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

DNOs and new contestable services

Whilst we are committed to our role as a neutral market facilitator and understand the importance of neutrality as we move forward, we recognise that monopolies have an important role to play in ensuring that consumers are not exposed to undue market costs, particularly as markets develop and become sufficiently liquid. It is important that Ofgem and industry work together on this to ensure that there is transparency and a common understanding and acceptance of any decision that involves DNOs / DSOs acting in potentially more contestable areas. We do not want to be seen to be undermining the competitive market.

We agree that this mandates a case-by-case approach, particularly during the early stages of this transition. Recognising the assets in place or the extent to which they might be used, it may, for instance, be appropriate for a DNO / DSO to provide a service in one area, but not across its region or in another Distribution Services Area altogether.

We note the characteristics that Ofgem is mindful of: (i) vertical integration; (ii) competitive edge as a result of being a monopoly; and (iii) conflict with our neutral market facilitator role. However, the key here is transparency around decision-making and how these assets are used and funded. We therefore believe that this should be the core focus for this work and workstream.

Key enablers for DSO functions

We agree with Ofgem's work programme in this area given the importance of data visibility and transparency in the success of the energy system transition and we welcome the consistency with the recommendations established by the Energy Data Taskforce.

Perhaps the intention is to pick this up in the consultation on the Long-Term Development Statement (LTDS) later this year, but one of the key aspects of this work needs to be to look objectively at what data is needed / most valued and to prioritise this work on this basis. There are legal and regulatory barriers that need to be addressed and this work needs to also consider and overcome these.

Development of coordinated flexibility markets

Whilst we do not disagree with the areas that Ofgem has listed, we consider the main challenge in the development of coordinated flexibility markets to be the contractual framework that clearly assigns responsibility and accountability and ensures that other parties have the same long-term interests in the network and its consumers. We are already actively involved in work through the ENA Open Networks Project to develop this contractual framework, but for parties to contract, they need to understand and be prepared to accept reasonable terms and conditions.

We absolutely see the links between this work and the work of the Charging Futures Forum and believe that this will be key in ensuring that flexibility providers have more appropriate price signals and clarity over what to expect, not least in relation to curtailment. We would urge Ofgem to remain realistic in terms of what monopolies can deliver in this space in advance of these charging reforms taking effect in April 2023.

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

We have invested in a number of flagship projects: Project Transition, Project LEO and Modelling the Economic Reaction Linking the Individual Networks (MERLIN). Projects Transition and LEO are already underway; MERLIN is just kicking off now and the projects will finish in October 2021, October 2022 and January 2021 respectively.

All of these are specifically designed to develop understanding of Distribution system operation and how this will interact with the emerging market.

We are also working with two of the winners of BEIS' Flexibility Exchange Demonstration (Flex) Competition, where we are working to understand how we, as a DSO, can support these markets.

We would expect Ofgem to be monitoring all of these projects with interest in order to understand how the various functionalities and capabilities can and will be delivered and to reflect this in its own understanding and views of the energy system. We are creating a lot of real and practical learning and it is key that Ofgem takes this into account in its role in shaping the regulatory framework.