

23/08/2019

## Energy UK Response – Ofgem Position paper on Distribution System Operation

Submitted via email only

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses.

The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

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Energy UK welcomes the opportunity to respond to this consultation as well as the increased focus on this area of regulation from Ofgem. Energy UK does not, however, find this position paper to be sufficient to address the concerns of industry. This paper seems to hold no new information and seems to be a further delay to tangible progress in regulating the evolving roles and responsibilities across the system.

This response should be examined alongside Energy UK's response to Ofgem's open letter consultation on the RIIO-ED2 framework, as the two responses are heavily related.

Energy UK holds the following core positions:

- The participation of ENWL in competitive markets is viewed as a market distortion by providers and is undermining investor confidence and the nascent GB market for flexibility. It is concerning that the number of participants in FFR tender rounds has reduced. Energy UK would again ask that the participation of ENWL be stopped until such a time as Ofgem has fully consulted on this issue. If not willing to take this action, then Ofgem should bring forward their consultation on the treatment of CLASS to address this as a priority ahead of RIIO ED2.
- Continued delays to decisions on DSO functions and new DNO activities have undermined implementation of GB markets for flexibility and is preventing the delivery of a whole system solution. This is resulting in a move towards the 'slow start' scenario set out by Imperial College in its 2016 analysis for BEIS and Ofgem.
- To establish a level playing field for all actors that wish to provide DSO functions, Ofgem, BEIS, and the DNOs must implement tangible changes reflective of the recommendations of the Energy Data Taskforce.

Ofgem's consultation on the utilisation of flexible network assets should look to define when and how those assets are called upon outside of the competitive market, with Energy UK's preference for that to be in instances of market failure or to provide support in emergency situations such as those seen on 9 August. This decision must be based on an evidenced approach that sets out a clear long term benefit for consumers.

It is, based on research performed for BEIS<sup>1</sup>, in the interests of all consumers to ensure the development of robust competitive markets for flexibility, and industry is not confident that this will be delivered in a timely manner. Energy UK is working with other trade associations to develop a paper setting out ways in which these issues and others related to the Smart Systems and Flexibility Plan

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<sup>1</sup> An Analysis of Electricity System Flexibility for Great Britain - [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/568982/An\\_analysis\\_of\\_electricity\\_flexibility\\_for\\_Great\\_Britain.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/568982/An_analysis_of_electricity_flexibility_for_Great_Britain.pdf)

(SSFP) are not being delivered, and the potential impacts of slow progress. That paper will be shared with BEIS and Ofgem ahead of publication.

Energy UK will continue to engage in this critical policy area wherever possible and we welcome any questions from Ofgem or wider stakeholders regarding this response.

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## **Question Responses**

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

Energy UK agrees with these broad strategic outcomes.

There remain a number of decisions on the responsibilities of different actors in distribution system operation that need to be made for these to be achieved. Energy UK believes that by delaying decisions on these issues, Ofgem is risking failure in terms of achieving these outcomes in an efficient manner that is delivered at lowest cost to consumers.

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

Energy UK fully supports the development of clear roles and responsibilities between the market and monopolies, as we set out in a position paper in 2018<sup>2</sup>.

A level of uncertainty remains over the DSO activities and responsibilities for those actions, and decisions on this will take time. There is, however, a clear and, for the vast majority of cases, consistent position from Ofgem and wider European regulatory bodies for regulated monopolies being separated from competitive markets.

It is clear that where a regulated monopoly participates in a competitive market, this risks negative distortions that impact upon the sustainability and feasibility of those markets. For example, there is evidence to suggest that the participation of ENWL in ancillary services has had such an impact<sup>3</sup>, undercutting the market undermining the investment case for flexible assets by industry parties. The lack of clarity over why the DRS8 decision was taken and the intended future relationship between balancing services and network balancing has not been addressed by this position paper, and further work is required.

Not defining this interaction has resulted in a deterioration of market confidence and will contribute to the GB market alignment with the 'slow start' scenario set out in the 2016 analysis delivered by Imperial College ahead of the development of the SSFP. We welcome Ofgem's intention to consult on these issues but they should be addressed more urgently than set out in the position paper to avoid the 'slow start' scenario. This would also mitigate the growing perception that Ofgem wishes to use network assets to deliver all GB flexibility.

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

Energy UK supports the development of effective competition, and would note that this must be approached with a long-term focus. Developing effective markets will take time and needs to be delivered urgently to ensure that a smart flexible energy system can deliver customer savings through the 2020s.

Energy UK would note that any market in which a single participant holds a monopoly position is not competitive. Industry participants have increasingly expressed concerns that ENWL already holds, in terms of Fast Reserve<sup>4</sup>, or will hold, in terms of other markets, such a position, and that other DNOs would similarly be able to use consumer funding to undercut risk and bid in below market actors to effectively secure a monopoly in any given market. Failing to resolve this risk and address industry perception will result in a lack of investment in GB and continued slow development of GB flexibility markets.

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<sup>2</sup> <https://www.energy-uk.org.uk/publication.html?task=file.download&id=6798>

<sup>3</sup> In terms of reduced participation and ENWL's sole successful bid within August 2019 Fast Reserve tender.

<sup>4</sup> Fast Reserve Post Tender Assessment Report August 2019 - <https://www.nationalgrideso.com/document/151026/download>

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

Energy UK fully agrees with this principle and would note the importance of ensuring that DNOs are not incentivised to give unfavourable connection offers to those offering flexibility of any technology type. This includes not only those flexible assets that could compete with network assets in ancillary services, but those which could free up network capacity and reduce the need for network reinforcement. Energy UK, therefore, welcomes this principle in particular and holds it as vital to market development.

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.

Work being progressed under the Open Networks project to ensure a single process for connection queue management and interactivity show high potential in terms of their impact on simplification of processes. It is vital that those processes are implemented in a timely manner, but also important that customer feedback on those processes and any unintended consequences following implementation is noted and acted upon.

Strongly embedded whole electricity system outcomes

Energy UK supports the delivery of whole electricity system outcomes. It is important that the definition of 'detriment' is set out clearly to ensure that the interests of national consumers are not set as secondary to those of local consumers. For example, if one decision could result in either a £1 per customer reduction in national system costs or could be utilised to reduce the bills of consumers in a single area by £2 each, then who makes that decision and how is it justified?

This area requires more comprehensive review, and we welcome the anticipated whole systems licence clarifications expected later in the year.

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

Energy UK does not find the workplan set out in this position paper to be sufficient to deliver the strategic outcomes set out not only in this document but also in the wider Smart Systems and Flexibility Plan. More timely decision making than set out in the workplan is necessary to deliver whole system solutions and facilitate opportunities for the energy system to be more efficient.

DNOs and new contestable services

The position paper states an aim to clarify how decisions made in this space are consistent and coherent. Energy UK welcomes this aim, we would note that the approach set out does not seem to differ to the accepted historic approach to decisions on acceptable DNO activities. Energy UK would, however, note that the DRS8 decision, the allowance of Project CLASS to participate in a competitive markets, not only went against the process set out in this position paper, but was at odds with all past Ofgem positioning.

Energy UK opposes the decision to delay giving more detailed guidance to DNOs on appropriate separation from markets. This uncertainty is undermining the investments and market positions of many industry participants, and has led to a lack of confidence in the market for flexibility. Beyond this, the lack of a full and public justification, with appropriate evidence and analysis, for decisions allowing DNOs to participate in these services, instead laying the burden of evidence on industry, is counter to transparent and open regulatory development.

With the passing of the European Clean Energy Package comes a restriction on acceptable activities by DNOs, specifically requiring that DNOs not be allowed to own or operate energy storage or electric

vehicle chargepoints. Given the long time period seen across regulatory changes in the past two years and the requirement for the UK to implement this change within 18 months, Energy UK supports swift implementation of these requirements into distribution licensing and surrounding regulatory frameworks, including the Smart Energy Code.

Given the clear detrimental impact on market confidence, with ENWL vastly undercutting competitors in FR and FFR markets, Energy UK would ask that Ofgem set out publicly why Project CLASS assets were allowed to participate in the market before a full and open consultation process. Ofgem's own positioning on regulated monopoly participation in competitive markets sets out the exact scenario now seen in the market, with competition by a DNO's regulated asset base increasing the risk of market distortion and deterring new entrants.

To consult after the fact undermines the ability of industry to input into the decision making process, and the lack of a transparent and public explanation of the rationale behind the decision following these concerns being raised on numerous occasions by numerous industry actors continues to undermine the relationship between regulator and industry. The lack of tangible progress in separating regulated monopolies from competitive markets following continued and consistent requests from industry has further eroded confidence in Ofgem's interest in and ability to deliver under this workstream.

#### Key enablers for DSO functions

Energy UK supports the proposed focus in this section, particularly the focus on opening up system and network data to enable effective investment from industry.

The open letter from BEIS and Ofgem requesting that the ENA and its members progress tangible outputs from the Open Networks project<sup>5</sup> was a welcome intervention. Energy UK also welcomed and supports the findings of the Energy Data Taskforce and would note the importance of applying those principles to all regulated assets.

Creating transparency of the state of the network and standardising processes across DNOs are vital elements of enabling a wide range of participants to develop their own approach to DSO functions. Without action in this area, DNOs will continue to be the only actors able to develop DSO functions. We would note that if these changes are not implemented by DNOs, it will be important that Ofgem intervene in a timely manner to ensure delivery.

#### Development of coordinated flexibility markets

Energy UK agrees with the outline for this workstream, but would note the importance of setting out a timeline for DNO implementation of the requirements set out in this section. It is important that a timeline is established for the actions to ensure that Ofgem is able to hold DNOs to account if they are not delivering appropriate changes.

The ENA has played a valuable role in driving coordination through the Open Networks project, but does not have the powers of Ofgem and as such cannot hold its members to account for non-delivery. Again, Ofgem must be willing to intervene if DNOs are not delivering tangible change in a timely manner.

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

Energy UK would again raise the need for urgency in delivering reforms and enabling the development of markets for flexibility in the near term. Analysis used by Ofgem and BEIS to support the SSFP sets out the importance of delivering effective market mechanisms and developing mature

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<sup>5</sup> <https://www.ofgem.gov.uk/publications-and-updates/open-letter-ena-open-networks-project-ofgem-and-beis>

markets for flexibility in the early 2020s. Energy UK does not have confidence that the progress made to date will deliver in the timescales intended and would ask for a renewed vigour in the delivery of these changes.

Stakeholders should also be given the opportunity to input into the development of a collated resource of real and perceived conflicts of interest across system operation and flexibility service procurement to ensure that mitigating actions can be enacted or recommended to Ofgem and BEIS. While this work is being progressed by the ENA under the Open Networks project, Energy UK would flag the conflict of interest apparent in charging networks with defining their own potential areas of conflict.