

Zenobē Energy's Response to Ofgem's Consultation:

`Position paper on Distribution System Operation & Open Letter Consultation on approach to setting the next electricity distribution price control (RIIO-ED2)'

15th October 2019

Introduction

Zenobē Energy (Zenobē) is the leading UK-based owner and operator of grid-connected batteries, financed by over £80 million of equity invested by the board, private investors a US-based early-stage infrastructure fund and Jera, a joint venture between TEPCO and CHUBU, the two largest generators in Japan. The company has built, owns and operates over 72 MW of 'In-Front-of-Meter' commissioned assets spread across eight sites. Its portfolio of batteries is contracted to supply services to National Grid, including Fast Reserve, FFR, Capacity Market T-1 and T-4 (the latter are currently suspended).

In addition to providing services to National Grid and the EMR, Zenobē also provides its battery and financing expertise to support fleet operators to make the transition to electric vehicles. In May 2019, we launched up to £120 million of funding to accelerate the rollout of commercial electric vehicle fleets. Our site at Guildford for Stagecoach is the first battery and charger combination supporting the charging of EV buses with other schemes being built and commissioned by Zenobē in Newport, London, Birmingham, Leeds and Coventry. The services provided by Zenobē include the design financing, installation and operation of charging infrastructure as well as the financing of batteries and the chassis of the buses/fleet EV vehicles. Currently, the company has or is in the process of negotiating contracts to support a total of >100 EV buses and the associated charging infrastructure.

Zenobē also offers its battery and financing knowledge through a range of services to commercial and industrial companies including utility companies such as water companies, to support their efforts to reduce their environmental impact and improve the use of renewable electricity.

Overall objectives

We support Ofgem's approach to Distribution System Operation policy development. The interests of future and current consumers are better protected by an energy system that can attract investment and innovation and keep costs as low as possible for consumers while also promoting sustainability.

However, we agree with Ofgem that where flexibility assets are owned by monopoly network operators, there is the potential for competition to be distorted.

Key points and recommendations

- Exemptions to flexibility services ownership and operation by DNOs should be carefully reviewed. When services can be provided by markets, DNOs should not be allowed to compete as they will distort the market and impede the deployment of new capital, e.g. storage assets should not be owned or operated by DNOs, we urge Ofgem to review the current exemptions.
- We believe Ofgem should consult stakeholders on all requests. Stakeholders need to be consulted to confirm that the relevant licensee took all reasonable steps to obtain a market-based solution. Stakeholders are best placed to identify the potential implications on the market of Ofgem issuing a direction.
- It might be that the markets do not have the size required nor have not developed new services. But in the near future innovation and transparency of data will allow participants to enter new markets. We believe that Ofgem should not make premature decisions that lock the energy system into path-dependent routes while there is still uncertainty about potential developments. Instead, the regulator should maintain optionality and flexibility. Therefore, exemptions should be limited in time.
- If limited exemptions for emergencies were found to be necessary in the case of proven market failure, these would need to be codified, and each asset would need to be assessed by Ofgem on a case by case basis.
- When exceptions are granted, we expect to see an explicit prohibition on the licensee using any exempted asset to provide ancillary services to the Electricity System Operator (or to any other DNO) in competition with market participants.
- Zenobē's view is that DNOs **should not** take on contestable roles, including having the capability to modulate EV chargers to resolve network and system needs that could also be met through market-based mechanisms.

Zenobé's comments on the Position paper on Distribution System Operation & the Open Letter Consultation on approach to setting the next electricity distribution price control (RIIO-ED2)

Contestable services

DNOs control the physical infrastructure needed to trade energy flexibility services. We understand Ofgem's decision to postpone the decision on whether the legal separation between DSO activities and DNOs is necessary, but we believe that it is vital to ensure that UK markets for flexibility continue to be competitive and attractive. There is a risk of DNOs unduly taking advantage of their monopoly positions or otherwise harmfully distorting the competitive delivery of services that could be provided by the markets.

We believe that currently, flexibility assets are not being rewarded at the right level (as can be seen by the removal of such assets from the flexibility auctions and their participation in other markets). CM revenues for renewables and storage are at its lowest level (or suspended), and de-rating factors of batteries continue to be increased. The current unresolved suspension of the CM (which has been substantially prolonged compared to the original estimates of when this would be resolved) and the fact that new-build assets were precluded from participating in the T-1 auctions have impacted investment in flexibility. Other markets such as FFR have cleared below breaking-even prices for such assets.

To encourage investment in new technologies and business models, new providers should have access to different sources of revenue supported by Ofgem. By allowing DNOs to compete in one or more of these markets, Ofgem would prevent new entrants from securing a sufficient level of return and thereby deploying new capital.

In addition to the current low levels of revenue for flexibility assets, DNOs have access to cheap capital, and it would be challenging for Ofgem to identify cross-subsidies with other DNO activities, further increasing the DNOs local monopoly and reducing the attractiveness of these markets for new capital. Allowing network companies to operate flexibility assets risks compromising efforts to establish flexibility markets revenues and could result in potential procured flexibility is not utilised because the network company is able to directly control the asset itself.

DNOs should **not take on contestable roles** if Ofgem wants to steer the development of new flexibility markets, vital to achieve an efficient system and deliver decarbonisation at least cost to consumers. Providing clear boundaries of DNO activities will give confidence to other providers, allowing them to better plan for investment.

DNOs & neutral facilitation of markets

To deliver price signal flexibility, we see as a priority that Ofgem ensures DNOs explore both long and short-term flexibility tenders as part of their business as usual network management. Zenobē urges Ofgem to carry on its work to ensure DNOs have more transparent, accurate and accessible data including constraint management, future reinforcement and demand forecast. Ofgem could facilitate the development of new markets and improve the existing ones by making it mandatory for DNOs to make network data visible and share this in an open, interoperable way particularly if Ofgem grants an exemption for DNOs to develop DSO capabilities. We expect procurement processes to converge to facilitate access to markets. This includes having coordinated product definitions, transparent decision-making processes and cost-benefit analyses.

There is a risk that the DNO is, or is perceived to be, biased towards 'make' (or buying from itself or affiliated party) even where this would not be the most efficient solution for consumers. DNOs have better visibility of data, constraints in the system, and market prices than other players. This could introduce barriers to entry and distort the markets, reducing potential benefits that could be delivered by effective competition. As mentioned before, DNOs have access to cheap capital and could make use of cross-subsidies (paid by all consumers) to offer their services at an apparent more competitive price, deterring investment, innovation and participation by new investors in the market which the DNOs participate.

Another barrier to entry, or perceived barrier to entry, is the tendering process. When DNOs are allowed to enter a market, this could distort neutral tendering of network management and reinforcement requirements, with level playing field between traditional and alternative solutions. We urge Ofgem to prevent conflict between DNOs commercial role and their neutral monopoly role. If DNOs are competing with for example a storage asset, they could defer the connection time, increase the cross of connection or allocate a more expensive LLFC and tariff level or by making useful network information public more slowly to improve their relative performance and therefore increase the cost of operating other flexible assets.

We would welcome the opportunity to meet with you to discuss our concerns and proposed solutions in greater detail. In the meantime, if you or colleagues have any immediate queries regarding Zenobē's consultation response, please do not hesitate to contact us.

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