

Enabling the competitive deployment of storage in a flexible energy system: changes to the electricity distribution licence

Consultation

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Overview:

Our energy system is changing, and we need to ensure the regulatory environment adapts to the deployment of new smart technologies and the emerging issues that they bring to the system.

Storage can open up many possibilities. It can help to integrate variable renewable generation, reduce the costs of operating the system, and help avoid or defer costly reinforcements to the network. However, it needs a level playing field to compete. In the *Smart Systems and Flexibility Plan* we committed to address the barriers we identified, through licencing, planning, connections and charges for storage, and in the way we enable storage to locate on the same site as renewable generation.

We are publishing two consultations to inform our work to deliver on our commitments in the *Smart Systems and Flexibility Plan*. This document seeks views on our proposals for ensuring that storage is sufficiently unbundled from network business. We have also published a separate consultation on modifying the electricity generation licence for storage.

Context

In our call for evidence, *Towards a Smart, Flexible Energy System* – published jointly with government - we committed to ensuring the energy system works for people and businesses. A smarter and more flexible system offers significant benefits for consumers and the economy. This can help to ensure the UK has a secure, affordable and clean energy system now and in the future, while helping to enable growth in all parts of the country.

Ofgem has a central role in helping this to happen through effective regulation of monopolies and enabling competitive markets. Having listened to stakeholders' views, Ofgem committed in its 2017-18 forward work programme to setting out a plan of action for removing regulatory barriers to storage. We announced the specific actions in the *Smart Systems and Flexibility Plan* in July this year.

In order to ensure that a competitive market for storage and other flexibility services can develop, and to ensure compliance with EU law, we committed in the plan to clarifying the regulatory position on ownership and operation of storage by network operators. We also committed to consulting on modifications to the generation licence to clarify the status of storage in the regulatory regime.

In this consultation, we outline the steps we propose to take to ensure the operation of storage is sufficiently unbundled from network businesses. A separate consultation, published alongside this one, sets out our proposals on modifications to the generation licence.

Associated documents

[Ofgem Corporate Strategy](#), December 2014

[Smart, Flexible Energy System – a call for evidence](#), November 2016

[Ofgem Forward Work Programme 2017-18](#), March 2017

[Upgrading our Energy System – smart systems and flexibility plan](#), July 2017

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Executive Summary

In the *Smart Systems and Flexibility Plan*, we committed to a number of actions to enable consumers to benefit from flexibility. These included changes to the roles and responsibilities of network companies and facilitating competition between different forms of flexibility.

In this document, we are consulting on a new condition in the electricity distribution licence to ensure that distribution network operators cannot operate storage. This corresponds with action 1.8 of the *Smart Systems and Flexibility Plan*.

Storage can help to integrate intermittent renewable generation, reduce the costs of operating the system, and help avoid or defer costly reinforcements to the network. However, it needs a level playing field to compete in the relevant markets.

In the case of networks owning and operating storage, distortions or foreclosure have the potential to affect not just the uptake of storage by third party providers, but also the uptake of other forms of flexibility – such as demand side response (DSR) or other flexible generators – that provide the same or similar services in the same markets. This in turn has the potential to impact on other markets, including that for aggregation.

However, electricity storage can be a valuable source of flexibility for system and network operation, offering an alternative solution to avoid or defer the need for traditional reinforcement or to support cheaper and faster network connections. We need to make sure that there is the right regulatory framework to make efficient and effective use of flexibility provided by the market.

We are proposing to introduce a new condition in the electricity distribution licence to ensure that distribution network operators (DNOs) cannot operate storage. However, we acknowledge that there are a small number of activities or very specific circumstances, where a DNO operating a storage asset may be acceptable. Our proposals, therefore, provide a mechanism for DNOs' to operate storage, but only with explicit permission from us. We would expect these circumstances to be very limited, and the onus will be on DNOs to make the case in each instance that DNO-operated storage is in the best interests of customers and would not be detrimental to competition.

The new condition would be accompanied by a guidance document that would clarify how DNOs may participate in storage projects in a way that appropriately manages potential conflicts of interest. It would also described how and under what circumstances special permission might be granted to a DNO to operate directly a storage facility. We also provide some initial views on the reporting regime that would be in place to allow us to monitor the effectiveness of the framework for the unbundling of storage.

1. Background

Chapter Summary

We want to see competitive markets for flexibility services to the grid. We think action to clarify the regulatory framework for storage is needed to facilitate this.

A smart flexible energy system

- 1.1. In the *Smart Systems and Flexibility Plan*, we committed to taking action to ensure an energy system that works for people and businesses – including technologies like storage. We set out our vision for a smarter and more flexible system that offers significant benefits for consumers.
- 1.2. The share of intermittent generation connected to the electricity grid is growing and is expected to continue to do so. To manage their systems, the network companies will increasingly need to use flexible resources. To do this effectively and efficiently, their roles and responsibilities will need to change and, in particular the distribution network operators (DNOs) will need to embed distribution system operator (DSO) roles.
- 1.3. DNOs need to become more proactive in their management of the network and have an important role to play in facilitating markets. As this happens, we need to make sure they have the right regulatory framework.
- 1.4. DSOs will need to be entirely impartial in the way they undertake their functions. This means making sure that they do not have any conflicts of interest, including when making decisions about where and when to invest in the network, or how to operate their networks at any given moment.

Storage and flexibility

- 1.5. Electricity storage can be a valuable source of flexibility for network operators, offering an alternative solution to avoid or defer the need for traditional reinforcement or to support cheaper and faster network connections. Storage facilities can also be used to provide balancing services, and other ancillary services to the system operator.
- 1.6. By removing barriers to technologies like storage, we can enable more participants to provide flexibility in managing the system. This will help deliver cost savings and security of supply for the current and future system by creating greater competition for grid services.

Risks to competitive markets of monopoly participation

- 1.7. Where competitive activities are carried out by monopoly network operators, there is potential for competition to be distorted, for new market entrants to be deterred, and for network operators' incentives to invest efficiently in their networks to be affected.
- 1.8. Because network companies control the infrastructure needed to trade energy and flexibility services, they have the ability to restrict the activities of market participants by denying (or otherwise impeding) their network access. If a network company is also participating in the competitive market, it may have a strong incentive to use this ability to gain an unfair advantage over its rivals. The network companies' incentives to invest efficiently in the network can also be affected, if decisions are driven by shorter-term market signals, rather than longer-term investment signals. Finally, there can also be circumstances where the network company has information not available to the wider market, which might give it an undue advantage in competitive activities. It is important that these risks are managed.
- 1.9. New technologies and business models are creating new opportunities for competition. We must ensure that the expansion of DSO roles does not cross the boundary into activities which can efficiently and practicably be left to a competitive market.
- 1.10. In the case of network-owned and operated storage, distortions or foreclosure have the potential to affect not just the uptake of storage by third party providers, but also the uptake of other forms of flexibility – such as DSR or other flexible generators – that provide the same or similar services in the same markets. This in turn has the potential to impact on other markets, including that for commercial aggregation. GB has a competitive market for aggregation of flexibility services that has potential to deliver significant benefits to GB consumers by facilitating wider provision of flexibility.
- 1.11. This document focuses on ensuring the right arrangements are in place for storage. It is worth noting that our central principles of maintaining competitive markets and ensuring DSOs remain impartial extend to other areas of DSO activity. For example, we also consider that DSO involvement in commercial aggregation risks having a negative effect on that market and undermining the impartiality of the DSOs. As such, we do not believe that this is an appropriate activity for DSOs to engage in.
- 1.12. In line with these principles and the vision set out in the *Smart Systems and Flexibility Plan*, we will continue to consider where further changes may be needed to the roles and regulatory arrangements for DSOs to ensure potential future conflicts of interest are managed effectively.

Storage as a subset of generation

- 1.13. Another key area we address in the *Smart System and Flexibility Plan* is the need for improved regulatory clarity on the treatment of electricity storage in the current regulatory framework. This needs to take into consideration that electricity storage encompasses many diverse technologies and business models.
- 1.14. We concluded that storage should be treated as a form of generation within the existing framework. This is because generation and storage share similar characteristics and perform similar functions in terms of generating and exporting electricity onto the grid. In a separate consultation published alongside this one, we set out our proposals for making changes to the electricity generation licence to better incorporate storage into the framework.¹ These proposals include providing a definition of storage, as a subset of generation, into the generation licence.

Separation of monopolies from competitive markets

- 1.15. In our *Smart, Flexible Energy System* call for evidence, we sought views on the use and ownership of storage by network companies. At the same time as confirming the potential value of storage services to network operators and the wider system, many respondents echoed our own concerns in relation to the significant potential effects on competitive markets of network operators owning and operating storage.² We concluded in the *Smart Systems and Flexibility Plan* that network operators should not own or operate storage. This is also in line with proposals and European level. In this consultation, we set out our proposals on first steps for addressing these concerns.
- 1.16. The kinds of concerns outlined above are well understood because they also exist where network monopolies could be active in other, more traditional competitive activities like generation and supply. This means there are existing requirements on network operators to address them - set out in EU and UK legislation as well as in their licences. These measures require network companies to be run separately from competitive activities and are referred to as "unbundling".³
- 1.17. At transmission level, these rules already severely restrict the network monopolies from owning or operating any generation, including storage, and

¹ This can be found [here](#) under 'publications and updates'

² Responses to the *Smart, Flexible Energy System* call for evidence are published [here](#).

³ The existing unbundling arrangements at distribution and transmission level are described in more detail in Annex 2.



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Ofgem has a role in approving the companies' arrangements. Therefore, we do not consider there is any immediate case for revisiting these arrangements.

- 1.18. At distribution level, the rules are clear that the DNOs cannot directly own or operate large-scale storage over 100MW. However, because generation below this threshold does not require a generation licence,⁴ there is a grey area where DNOs can own smaller scale storage. A number of respondents to the *Smart, Flexible Energy System* call for evidence raised concerns that this makes the current unbundling requirements insufficient to prevent DNOs (or subsidiaries) from potentially distorting or foreclosing flexibility markets.

Rationale for taking action

- 1.19. We believe that there is merit in these concerns and, in line with existing EU unbundling rules,⁵ we want to clarify that DNOs must ensure there is operational separation between the DNO activities and storage assets, even where the asset is licence exempt.
- 1.20. Our view is that over time – as the role of the DNOs continues to evolve and the potential for conflicts of interests consequently increases – there will be a need for the unbundling regime to be strengthened to include separate ownership of storage.
- 1.21. This is consistent with the direction of future European rules on storage ownership. In its *Clean Energy for all Europeans* package,⁶ the European Commission is proposing to prohibit DNOs from owning, managing or operating storage facilities – except in very limited circumstances. Regulators across Europe have welcomed and supported these proposals.⁷
- 1.22. We see clarifying the existing regime as a minimum first step, while we consider how best to give effect to our longer term policy position. The steps outlined in this consultation will ensure that DNOs apply effective operational unbundling to all storage, and in particular licence exempt generation (including storage). This will guarantee that minimum protections are in place to manage potential DNO conflicts of interest as work is carried out to develop markets for flexibility

⁴ Under the Electricity Act 1989, the Secretary of State may grant to generators below 100MW an exemption from the obligation to hold a generation licence. In practice, government policy has been to grant an automatic exemption to generators below 50MW. Generators between 50MW and 100MW must apply for an exemption, granted at the discretion of the Secretary of State. More information on licence exemptions can be found [here](#).

⁵ The EU Electricity Directive can be found [here](#).

⁶ The Commission's proposals can be found in their entirety [here](#).

⁷ The Council of European Energy Regulators' White Paper on the Future Role of the DSO, addressing the Commission's storage ownership proposals can be found [here](#).



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and to evolve the role of the DNOs. At the same time, the proposed action does not close off the possibility of, or narrow the scope of, future work in this area.

- 1.23. Most importantly, this first step is a signal to the DNOs and the market of the direction of travel in the regulatory framework. We will keep this area under review and will continue to develop DNO unbundling arrangements as developments in relevant markets dictate.

2. Proposed new condition in the electricity distribution licence

Chapter Summary

We plan to introduce a new licence condition to ensure distribution network operators are legally separate from the operation of storage facilities, regardless of whether they are required to have a generation licence. We are consulting stakeholders on the details of the new condition.

Question box

Question 1: Do you agree that the proposed new condition will ensure legal unbundling of DNOs from the operation of storage that benefits from an exemption to hold a generation licence?

Question 2: Do you agree that the same principles of unbundling should apply to IDNOs?

Do you have any views on the application of the specific new condition proposed here applying to IDNOs?

Question 3: Do you agree that DNOs should be able to directly own and operate small-scale storage for the purposes of providing uninterruptible power supplies (UPS) at substations?

Do you agree that DNOs should be able to directly own and operate small-scale storage for the time-limited purposes of emergency restoration and maintenance?

Do you think DNOs should be able to directly own and operate storage for any other specific applications?

Question 4: Do you have any views on the treatment of existing islanded system generation currently owned by DNOs?

Do you have any views on the treatment of future use of DNO owned and operated generation of storage in similar island situations?

New Condition 43B – prohibiting DNO operation of storage

- 2.1. We are proposing to amend the Electricity Distribution Licence to clarify that the legal unbundling requirements on DNOs of Article 26 of the European Directive apply to the operation of all sizes of generation and storage regardless of their licence status. We believe that the same principles of

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unbundling should apply to Independent DNOs (IDNOs) and consider that the proposals set out here should be replicated in the IDNO licence.

- 2.2. The new Condition 43B will be inserted into Chapter 11 of the licence. It will prohibit DNOs from carrying out any generation activities, which includes storage, except with our consent.⁸
- 2.3. While continuing to allow DNOs to *own* storage and generation assets for now, the new condition would ensure that DNOs could not *operate* the asset themselves. The operation would have to be carried out by a legally separate party. This would preferably be an entirely independent third party but could be a legally separate affiliate of the DNO.
- 2.4. DNOs are already required to have in place a compliance statement setting out how they will ensure that there is effective management and operational separation between the DNO and any affiliate company holding a generation licence. The new condition we are proposing will extend these separation requirements to the operation of any unlicensed storage.
- 2.5. In practice, this will mean that even if an affiliate of the DNO is tasked with the operation of a storage asset owned by the DNO, it will have to be run separately from the DNO as though it were a third party.

Exceptions to the prohibition under the new condition

- 2.6. We recognise that there are certain small-scale applications of DNO-operated generation (including storage) that help to ensure the safe and reliable operation of the network, and which we consider to be within the normal business activities of the DNO. We are, therefore, proposing to ensure that they are excluded from prohibition under the new condition -
 - **Uninterruptible power supplies (UPS)** – these are devices used at substations and other DNO sites to ensure that critical equipment remains energised in the event of a system outage – allowing the DNO to safely manage its system. These devices do not export electricity to the network and are necessary for the safe, efficient and reliable operation of the DNOs’ networks.
 - **Emergency response and maintenance fleets** for ensuring continuity of supply in outage situations – each of the DNOs owns a fleet of small, mobile generator units of between 50kW and 1.5MW which they use in outage situations to keep customers on supply. In future, if not already, storage units may be used for similar

⁸ Our initial proposed text for this new condition and associated changes to Chapter 11 is included in Annex 1 of this document. We welcome comments on the proposed text.

purposes. We consider that customers benefit from these applications through improved reliability and security of supply, and do not consider that these applications necessarily give rise to the concerns described above.

- 2.7. We do not consider that it would be appropriate to prevent DNOs continuing to operate the above small-scale assets for short periods on their networks for these purposes. We are proposing that the new condition should thus not capture these uses of generation assets (including storage). The possibility of such exceptions is in line with potential European rule changes in the Clean Energy Package.
- 2.8. We welcome your views on these proposed exceptions to the new condition. We would particularly like to hear from you, if you think there are any further applications of storage or generation by DNOs that should not be captured by the requirement to legally separate operation from the DNO.
- 2.9. We also welcome views on the best way to achieve any exceptions. Defining the exceptions within the new licence condition could provide the most obvious solution. However, defining these technical activities within the licence in a robust way would likely be very challenging. If the definitions were too broad, too narrow or unclear, this could risk undermining the intent of the condition or the exceptions. It is also important to ensure that licence conditions are as future-proof as possible. As technologies and markets develop, there is a risk that the defined exception would no longer meet their intended purpose.
- 2.10. We are therefore proposing that the new licence condition will not include any specific exception but to define the exceptions within an associated guidance document that will accompany the new licence condition – the scope and purpose of this proposed guidance are the subject of the next chapter.

Specific consents for other applications of storage

- 2.11. New technologies and new players are entering the market, while at the same time the roles of existing parties are evolving. We have said that we see the role of the DSO as a facilitator of flexibility markets, including new local markets. We expect DSOs to be able to procure services competitively from flexible resources in the market – be they storage, DSR or other flexible generators.
- 2.12. As the system undergoes this transition, there may be a very limited number of exceptional circumstances where we might consider it acceptable for DNOs to operate storage directly. We are proposing that the new condition should allow for this, but that it must be subject to our specific consent and subject to robust scrutiny. This consent will be granted via a Direction from us.
- 2.13. We would expect the DNO to justify a request to depart from the usual unbundling rules. DNOs would need to demonstrate that every possible effort



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had been made by to seek a market-based solution,⁹ and that a DNO-operated storage facility is the most economic and efficient solution.

2.14. We are proposing that we would have scope to place conditions on the DNO when we issue a Direction. Such conditions could include -

- Time limits on the consent after which the DNO would have to reapply for consent or unbundled operation – we would expect all consents to be time-limited.
- Requirements to put in place additional monitoring or reporting procedures.
- Requirements to put in place additional measures to manage potential conflicts of interest.

2.15. We are proposing that consent would be granted subject to a process and assessment criteria set out in guidance issued under the new licence condition. The objectives and proposed content of this guidance are addressed in the next chapter.

Treatment of existing islanded network generation

2.16. The proposed new condition is drafted to create a prohibition on DNOs from carrying out all generation, including storage.

2.17. A number of DNOs currently own and directly operate a small number generation assets on islanded networks. We are not proposing for the DNOs to have to alter the arrangements they currently have in place for these sites. These are long standing arrangements that have worked for consumers.

2.18. However, we do consider that for new sites of this kind, or for replacements of assets at the existing sites, the DNOs would need to apply to us under the new condition proposed here for permission to operate the assets directly. This would include the need to demonstrate that a market-based solution has been sought, for example through an open and competitive tender for a solution not involving any DNO ownership or operation.¹⁰ This is broadly consistent with the approach applied in the new energy solution for Shetland. In which the DNO, Scottish Hydro Electric Power Distribution, tendered to the open market for solutions to meet the energy needs of Shetland.

⁹ In this context, a 'market-based' means a solution provided by a third party on a competitive basis, such that no DNO ownership or operation is involved.

¹⁰ Requirements for receiving permission are discussed further in chapter 3.



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- 2.19. This approach would avoid unduly affecting arrangements for existing assets, where investments have been made. It would also allow the practice of DNO-owned and operated generation to continue in principle. At the same time, applying the new condition in future would ensure that the arrangements represent the best value for consumers' money by requiring DNOs to make every effort to find competitive, market-based solutions – where this is efficient.

Treatment of existing DNO-owned and operated storage

- 2.20. Currently a number of DNOs also own and operate storage facilities built under Low Carbon Network Fund (LCNF) innovation funding. These facilities add up in total to around 12.6MW of battery storage and vary in size from 50kW to 6MW.¹¹
- 2.21. These LCNF projects were intended to trial new technologies, systems and commercial and network operating arrangements. The aim of the projects was to help all DNOs understand how they could provide security of supply while delivering value for money to consumers as GB moved towards a low carbon economy.
- 2.22. As innovation trials, these projects have delivered a huge amount of knowledge about the potential uses and capability of storage technology at distribution level. Many of these projects are coming to an end, or in recent months have come to an end. We plan to work with each of the relevant DNOs to find the most appropriate treatment of these existing storage assets on an enduring basis.
- 2.23. In these discussions, we will be mindful that customers' money has already been spent on these projects and will seek to ensure that they continue to get best value for money from these assets until they reach the end of their use. This will mean finding the best solutions on a case-by-case basis according to the arrangements currently in place. However, any enduring arrangements for these storage assets will not give precedent for the treatment of future storage projects by DNOs, which will have to follow the unbundling rules.

¹¹ EA Technology provides an overview of these projects [here](#) in its *Good Practice Guide on Electrical Energy Storage*.

3. Guidance document

Chapter Summary

We will issue guidance to the DNOs setting out how DNOs may apply for consent to operate storage or generation assets directly under the new condition, it will also set out the criteria we will apply when making our decision.

Question box

Question 1: What are your views on the three high-level criteria proposed as the basis for assessing applications for consent?

Do think there are other criteria which should also be included?

Question 2: Do you have any other views on the scope or content of the proposed guidance document?

Question 3: Do you have any views on the process that should apply to the assessment of applications?

Clarifying the application of new Condition 43B

Purpose and scope of guidance document

- 3.1. The new licence condition will state that we will publish guidance. The guidance will form part of the licence condition and thus will be legally binding. The process and timelines for issuing the guidance document (or making subsequent changes) will be defined in the licence condition. This process will include consultation with stakeholders to ensure that the guidance is clear and fit for purpose.
- 3.2. The guidance would aim to -
 - Clarify when we would expect the DNOs to apply for an exception from the new condition.
 - Set out the criteria that we will take into account when assessing applications.
 - Describe how the DNOs should apply and the potential timescales for our decision.

Applications for specific consent to operate storage

Circumstances under which DNOs would need to apply

- 3.3. In the guidance document, we propose to set out at a high level the circumstances under which we would expect the DNOs to apply for an exception and when they should not.
- 3.4. Where there is legal separation of operation - In the first instance, DNOs should satisfy themselves that their arrangements meet the obligations under EU and GB legislation (including their licence) legally to separate the operation of generation or storage assets. If the DNO is satisfied that its arrangements meet those requirements it **would not be required** to apply for an exception.
- 3.5. While it would be for the DNO to put in place appropriate commercial arrangements with third parties, we would not expect contracts to provide the DNO with a greater level of control over the operation of that asset than it would have over another third party's asset. Equally, the DNO would need to ensure that those running the asset would not have access to confidential information about the network that other participants would not have access to.
- 3.6. Where the DNO operates storage or generation for specific named activities - The DNO would **not be required** to apply for a special consent where assets are operated by DNOs for specific uses. These uses would be described in detail in the guidance document. These uses, which we outline in the previous sections, would be limited to -
- Operation of uninterruptible power supplies (UPS) at substations
 - Emergency response and maintenance
- 3.7. Where the DNO does not have legal separation of operation and uses an asset for purposes other than specific named exception - **The DNO would need to apply for an exception** if its arrangements do not provide legal separation of operation and the DNO uses the asset for a purpose other than the specified exceptions. Applications for consent would be assessed against criteria set out in the guidance document.

Criteria we would consider when assessing applications for specific consent

- 3.8. We are proposing that there would be three core criteria that the DNO must demonstrate had been met before we would provide consent for the DNO to operate a storage facility directly.
- DNO must demonstrate that the **market is not able to provide an efficient solution** – This criterion would require the DNO to demonstrate that it had taken every possible step to obtain a competitive market-based solution at an efficient cost. In most cases, we would expect as a



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minimum that the DNO would have signalled its needs ahead of time and held well-designed and run, open and competitive tenders to the market.

- **Storage identified as the most economic and efficient solution** to a specific network issue – This criterion would require the DNO to demonstrate that a range of possible solutions had been considered with costs and benefits of each clearly identified and assessed.
- **Minimised conflicts of interest and mitigated potential distortions** to the market – the DNO would be expected to be able to put in place arrangements, other than legal unbundling, that would ensure the risks of discrimination or distortion to the market are effectively managed.

3.9. The guidance document would elaborate on these further and set clear expectations for the DNOs. We welcome your views on these proposed high-level criteria. In particular, we would be interested to know if you think there are any other specific criteria which would be included, or if you have comments on what you think the criteria outlined here should include.

Process and timelines

3.10. We are proposing that applications for consent would have to be submitted to us in writing. We would not expect to provide a formal template for applications. However, we would expect the guidance document to set out some minimum information that applications should include, in particular that applications should address how the DNO has met the criteria.

3.11. We are also proposing that applications could be submitted at any time, but that they must be made in good time to allow for a decision in advance of the DNO assuming operation of an asset.

3.12. We would expect the guidance to set a reasonable timeframe within we would normally make a decision. We consider that this process may involve an opportunity for stakeholders to input before consent is granted. This would help to ensure transparency, as well as the opportunity for us to gather additional evidence before making a decision. In some cases, this step could be a formal consultation. In this case, we would expect a longer timeframe to apply.

4. Reporting and monitoring

Chapter Summary

We plan to continue to monitor DNO involvement in storage activities to ensure that the unbundling regime is work effectively.

Question box

Question 1: Do you have any views on reporting requirements for DNOs that own/operate storage assets?

Question 2: Are there any particular types of data that, if published, could facilitate entry of competitive parties?

Is there any other information or data that you think DNOs hold about the deployment of storage on their networks that they could usefully make public?

Monitoring the ongoing effectiveness of the framework

- 4.1. Alongside the proposed new licence condition, we need to be able to monitor how the unbundling arrangements are working. This will mean making sure that we have access to relevant information about DNO involvement in storage projects.
- 4.2. Ofgem already has a range of monitoring and enforcement powers for ensuring compliance. We can undertake investigations on our own initiative or following the receipt of a complaint or a referral from other regulatory and consumer representative bodies. If we identify features of the market affecting or distorting competition, we could consider making a market investigation reference. We also have enforcement powers in respect of breaches of licence conditions, competition law and other relevant requirements.
- 4.3. Where a DNO contracts commercially for flexibility services from an independently owned and operated storage provider (ie where the DNO has no involvement in the ownership or operation), we would not expect to have any specific need to have oversight of these arrangements. Although we would expect such contracts to result from normal open and transparent procurement processes.
- 4.4. Where a DNO owns storage and reaches an agreement with a legally separate but affiliated company to operate the asset (ie where the DNO complies with the legal unbundling requirements set out in this consultation), conflicts of interest should be mitigated by the business separation rules already set out in the



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DNO licence. Existing compliance reporting obligations in the licence ensure that we have access to the details of such arrangements.

- 4.5. The development of markets for flexibility at distribution level require potential providers to have visibility of the needs of the DNOs – a signal from the ‘demand side’ of the market. This is why, in addition to clearly signalling areas of potential need, we want to see DNOs testing the market as much as they can before exploring solutions such as DNO-owned storage.
- 4.6. Where the market has not been able to provide a solution – and where we have granted consent under the new licence condition for a DNO to own and operate a particular storage unit - we consider that there would be a particular onus on the DNO to facilitate the development of a market in future.
- 4.7. Although consent would only be given where no efficient market solution was available, we consider that there are reasonable steps a DNO could take to enable a market to develop. For example, publishing usage data from these assets. This would help potential providers to better understand the DNO’s requirements and assess potential commercial models for providing a competitive service. If necessary, publication of these data could be a requirement set out in our Direction granting consent not to unbundled.
- 4.8. We are interested in your views on potential reporting requirements on DNOs, particularly in relation to information that should be provided about use of DNO-owned and operated assets. Are there specific types of data that you would consider to be particularly useful in signalling future needs?
- 4.9. We will consider responses to this consultation in developing our detailed policy position on monitoring and reporting of DNO-owned and DNO-operated storage. We will set these out publically in due course.

5. Next steps and future action

Chapter Summary

This chapter will set out the stages and expected timings for progressing this licence change.

- 5.1. This consultation is open until **27 November 2017**. Please send your responses to flexibility@ofgem.gov.uk.
- 5.2. We welcome responses from all interested stakeholders, but are particularly keen to hear from storage operators and DNOs. We will use responses to this consultation to refine our proposals for a change to the electricity distribution licence.
- 5.3. The next stage of the licence change process will be to issue a Statutory Consultation (StatCon). This is a legal requirement. We write to all affected licensees individually notifying them of our proposals, and setting out the exact drafting of the changes we propose to make. Pending consideration of responses to this consultation, we expect to proceed to the StatCon by early 2018. This consultation would be open for a minimum of 28 days.
- 5.4. Subject to our consideration of responses to the StatCon, we will aim to make our decision on whether to make the licence modification in Spring next year. Following the required 56-day standstill, we would expect the new condition to come into effect by Summer 2018.
- 5.5. Separately and in parallel, to the formal licence change process, we will also develop our views on the most appropriate reporting requirements on DNOs. We will make these public in due course and will take any steps required to ensure compliance.
- 5.6. At an appropriate stage following this consultation, we will also contact each of the relevant DNOs individually to initiate discussions about the treatment of existing DNO-owned and operated storage assets. As explained above in paragraph 2.23, our objective in these discussions will be to find suitable arrangements that ensure that consumers get the best value from the energy system.

Appendices

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Appendix 1 – Proposed changes to Chapter 11 of the Electricity Distribution Licence

Condition 42. Independence of the Distribution Business and restricted use of Confidential Information

Licensee's obligations

- 42.1 The licensee must put in place and at all times maintain managerial and operational systems that prevent any Relevant ~~Licence Holder~~ Undertaking from having access to Confidential Information except and to the extent that such information:
- (a) is made available on an equal basis to any Electricity Supplier, gas supplier, or gas shipper;
 - (b) is referable to a Customer who at the time to which the information relates was a Customer of the Relevant Licence Holder; or
 - (c) is of a type that has been confirmed by the Authority in Writing as corporate information.

Compliance Statement must always be in place

- 42.2 Except with the Authority's consent, the licensee must at all times have in place a Compliance Statement, approved by the Authority, that describes the practices, procedures, and systems which the licensee has adopted (or intends to adopt) to ensure compliance with paragraphs 42.1.
- 42.3 If the Authority does not direct the licensee to amend the Compliance Statement within 60 days of receiving it, the statement is to be treated as approved by the Authority.
- 42.4 The licensee must take all reasonable steps to ensure that it complies with the terms of the Compliance Statement in place under this condition.

Specific contents of the Compliance Statement

- 42.5 The Compliance Statement must, in particular, set out how the licensee will:
- (a) maintain the full managerial and operational independence of the Distribution Business from any Relevant ~~Licence Holder~~ Undertaking;
 - (b) maintain the branding of the Distribution Business so that it is fully

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independent from the branding used by any ~~Relevant Licence Holder~~ Undertaking; and

- (c) manage the transfer of employees from the Distribution Business to any ~~Relevant Licence Holder~~ Undertaking.

42.6 The Compliance Statement must also ensure that any arrangements to which the licensee is party that fall within any of the descriptions given in paragraph 42.7 are such as to prevent any breach of the requirements of paragraphs 42.1.

42.7 The arrangements referred to in paragraph 42.6 are those that enable any ~~Relevant Licence Holder~~ Undertaking, or any person engaged in or in respect of the activities of such ~~Relevant Licence Holder~~ Undertaking, to have any use of or access to:

- (a) premises or parts of premises occupied by persons engaged in, or in respect of, the management or operation of the Distribution Business;
- (b) systems for recording, processing, or storing data to which persons engaged in, or in respect of, the management or operation of the Distribution Business also have access;
- (c) equipment, facilities, or property employed for the management or operation of the Distribution Business; and
- (d) the services of any persons who are (whether or not as their principal occupation) engaged in, or in respect of, the management or operation of the Distribution Business.

Revision and publication of Compliance Statement

42.8 The licensee may, with the Authority's approval, revise a Compliance Statement prepared in accordance with paragraph 42.2.

42.9 The licensee must publish a copy of every Compliance Statement prepared in accordance with paragraph 42.2 (or revised in accordance with paragraph 42.8) on its Website (if it has one) within 21 days of its approval by the Authority.

Interpretation

42.10 In this condition:

Confidential Information means information relating to, or derived from, the Distribution Business that is not published or otherwise legitimately in the public domain.

Relevant [Undertaking] means either a Relevant Licence Holder, or a Relevant Exemption Holder.



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Relevant Licence Holder means any holder of:

- (a) a Supply Licence; or
- (b) a gas supply licence; or
- (c) a gas shipper licence; or
- (d) an electricity generation licence;

that is also an Affiliate or a Related Undertaking of the licensee.

Relevant Exemption Holder means a person who carries out the activity specified in Section 4(1)(a) of the Act and who is authorised to do so by an exemption pursuant to Section 5 of the Act, that is also an Affiliate or a Related Undertaking of the licensee.

Condition 43. Appointment of Compliance Officer

Purpose of appointment

43.1 The licensee must ensure, following consultation with the Authority, that a competent person (who is to be known as the Compliance Officer) is appointed for the purpose of facilitating the licensee's compliance with the Relevant Requirements.

Appropriate tasks for the Compliance Officer

43.2 The licensee must at all times ensure that the Compliance Officer is engaged for the performance of such duties and tasks as the licensee considers it appropriate to assign to him for the purpose specified at paragraph 43.1.

43.3 Those duties and tasks for the Compliance Officer must include:

- (a) providing relevant advice and information to the licensee for the purpose of facilitating its compliance with the Relevant Requirements;
- (b) monitoring the effectiveness of the practices, procedures, and systems adopted by the licensee in accordance with the Compliance Statement required under paragraph 2 of standard condition 42 (Independence of the Distribution Business and restricted use of Confidential Information);
- (c) advising whether, to the extent that the implementation of such practices, procedures, and systems requires the co-operation of any other person, they are designed so as reasonably to allow the required co-operation;
- (d) investigating any complaint or representation made available to him in accordance with paragraph 43.5;
- (e) recommending and advising on the remedial action that any such investigation has demonstrated to be necessary or desirable;
- (f) providing relevant advice and information to the licensee for the purpose of ensuring its effective implementation of the practices, procedures, and systems referred to at sub-paragraph (b), and of any remedial action recommended in accordance with sub-paragraph (e); and
- (g) reporting annually to the licensee's directors about his activities during the period covered by the report, including the fulfilment of any other duties assigned to him by the licensee under this condition.

Licensee's duties to the Compliance Officer

43.4 The licensee must ensure that the Compliance Officer is sufficiently independent to comply with the requirements of Article 26(2)(d) of the Directive and that he:

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- (a) is provided with such staff, premises, equipment, facilities, and other resources; and
- (b) has such access to the licensee's premises, systems, information, and documentation, as he might reasonably expect to require for the fulfilment of the duties and tasks assigned to him.

43.5 The licensee must give the Compliance Officer a copy of any complaint or representation that it receives from any person about a matter arising under or because of the Relevant Requirements.

Licensee's own Compliance Report

43.6 The licensee must, as soon as is reasonably practicable after receiving each annual report of the Compliance Officer under paragraph 43.3(g), produce a report ("the Compliance Report"):

- (a) about its compliance during the relevant year with the Relevant Requirements; and
- (b) about its implementation of the practices, procedures, and systems adopted in accordance with the Compliance Statement required under paragraph 2 of standard condition 42.

43.7 The Compliance Report produced in accordance with paragraph 43.6 must, in particular, do the things described in paragraphs 43.8 to 43.10.

43.8 It must detail the activities of the Compliance Officer during the relevant year.

43.9 It must refer to such other matters as are or may be appropriate in relation to the licensee's implementation of the practices, procedures, and systems adopted in accordance with the Compliance Statement required under paragraph 2 of standard condition 42.

43.10 It must set out the details of any investigations conducted by the Compliance Officer, including:

- (a) the number, type, and source of the complaints or representations on which those investigations were based;
- (b) the outcome of the investigations; and
- (c) any remedial action taken by the licensee following them.

Publication of Compliance Report

43.11 The licensee must:

- (a) give the Authority a copy of every Compliance Report; and
- (b) publish each such report on, and in a way that is readily accessible from, its Website (if it has one).

Interpretation

43.12 For the purposes of this condition, **Relevant Requirements** means:

- (a) the requirements of standard condition 42 (Independence of Distribution Business and restricted use of Confidential Information);

and, so far as they relate to relationships with Relevant Licence Holders within the meaning of standard condition 42, the requirements of:
- (b) paragraph 9 of standard condition 4 (No abuse of the licensee's special position) (which prohibits cross-subsidy between the licensee's Distribution Business and any other business of the licensee or of an Affiliate or Related Undertaking of the licensee);
- (c) paragraph 1 of standard condition 19 (Prohibition of discrimination under Chapters 4 and 5) (which prohibits the licensee from discriminating between any person or class or classes of persons when providing Use of System or connections or carrying out works for the purposes of connection); and
- (d) paragraphs 1 and 3 separately of standard condition 41 (Prohibition of discrimination under Chapter 9) (which prohibit the licensee from discriminating between any person or class or classes of persons when providing, respectively, Legacy Metering Equipment and Data Services).
- (e) the requirements of standard condition 43B (Prohibition on Generating by Licensee).

Condition 43A. Requirement for sufficiently independent directors

- 43A.1 Subject to paragraph 43A.11, except and to the extent that the Authority consents otherwise, the licensee must ensure that at all times after a date which is the later of:
- (a) 1 April 2014; and
 - (b) 12 months after this condition comes into effect in respect of the licensee,
- it has at least two non-executive directors who meet the criteria set out in paragraphs 43A.2, 43A.3, and 43A.5 below. In this condition such directors are referred to as “sufficiently independent directors”.
- 43A.2 A sufficiently independent director must:
- (a) be a natural person; and
 - (b) in the reasonable opinion of the licensee, have the skills, knowledge, experience, and personal qualities necessary to perform effectively as a non-executive director of the licensee; and
 - (c) not have any executive duties within the Distribution Business.
- 43A.3 Except and to the extent that the Authority consents otherwise, and subject to paragraph 43A.4, a sufficiently independent director must not be, and must not have been during the 12 months before his appointment as a director of the licensee or the coming into force of this condition (whichever is the later):
- (a) an employee of the licensee; or
 - (b) a director or employee of an Associate of the licensee.
- 43A.4 The reference to ‘director’ in sub-paragraph 43A.3(b) does not include appointment as a non-executive director of:
- (a) an Associate of the licensee that is the holder of a gas transporter licence or an electricity transmission licence or an electricity distribution licence;
 - (b) a wholly-owned subsidiary of the licensee that has been incorporated by it solely for the purpose of raising finance for a Permitted Purpose (as that term is defined in Standard condition 1 (Definitions for the standard conditions)); or
 - (c) a Qualifying Group Company.
- 43A.5 A sufficiently independent director must not:
- (a) have, or have had during the 12 months before his appointment as a director or the coming into force of this condition (whichever is the later),

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- any material business relationship with the licensee or any Associate of the licensee;
- (b) hold a remit to represent the interests of any particular shareholder or group of shareholders of the licensee or the interests of any Associate of the licensee; or
 - (c) receive remuneration from the licensee or any Associate of the licensee apart from a director's fee and reasonable expenses.
- 43A.6 For the purposes of sub-paragraphs 43A.5(a) and 43A.5(c) respectively:
- (a) the holding of a small number of shares or associated rights shall not, of itself, be considered a material business relationship; and
 - (b) the receipt or retention of any benefit accrued as a result of prior employment by or service with the licensee or any Associate of the licensee shall not be considered to be remuneration.
- 43A.7 The licensee must notify the Authority of the names of its sufficiently independent directors within 14 days of the later of the two dates referred to in paragraph 43A.1 and must notify the Authority within 14 days where any new directors are appointed to fulfil the obligation in paragraph 43A.11 of this condition.
- 43A.8 The terms of appointment of each sufficiently independent director must include a condition stipulating that both the licensee and the appointee will use their best endeavours to ensure that the appointee remains sufficiently independent during his term of office, having particular regard to the criteria set out in paragraphs 43A.2, 43A.3 and 43A.5.
- 43A.9 A term of appointment for a sufficiently independent director may not be for longer than eight years, but an individual may be reappointed thereafter provided that he continues to meet the criteria set out in paragraphs 43A.2, 43A.3, and 43A.5.
- 43A.10 The licensee must notify the Authority in Writing within 14 days if any sufficiently independent director is removed from office or resigns, giving reasons for the removal or (to the extent that they are known to the licensee) the resignation. For the purposes of this requirement, the reasons for a resignation may, if appropriate, be stated to be personal reasons.
- 43A.11 If at any time the licensee has fewer than two sufficiently independent directors because of a removal or resignation or other reason (including death or incapacity), the licensee must use its reasonable endeavours to ensure that a new director is, or new directors are, appointed to fulfil the obligation in paragraph 43A.1 as soon as is reasonably practicable to bring the number of sufficiently independent directors up to at least two.

Interpretation

- 43A.12 In this condition:

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Associate means:

- (a) an Affiliate or Related undertaking of the licensee;
- (b) an Ultimate Controller of the licensee;
- (c) a Participating Owner of the licensee; or
- (d) a Common Control Company.

Common Control Company means any company, any of whose Ultimate Controllers (applying the definition set out in standard condition 1 (Definitions for the standard conditions) but substituting that company for the licensee) is also an Ultimate Controller of the licensee.

Participating Owner – For the purposes of the definition of Associate above, a person is subject to a Participating Interest by another person (a **Participating Owner**) if:

- (a) that other person holds a Participating Interest in the person; or
- (b) the person is subject to a Participating Interest by a person who is himself subject to a Participating Interest by that other person.

Participating Interest has the meaning given in section 421A of the Financial Services and Markets Act 2000.

Qualifying Group Company means:

- (a) an immediate parent company of the licensee that holds 100% of the shares of the licensee and no other shares except for shares in one or more wholly-owned subsidiaries, each of which is the holder of a gas transporter licence or an electricity transmission licence or an electricity distribution licence;
- (b) the parent company of a group whose other members may only include :
 - (i) a company meeting the criteria set out in sub-paragraph (a) or a subsidiary of such a company, of the type referred to in that sub-paragraph; and
 - (ii) intermediate holding companies between the parent company concerned and a company meeting the criteria set out in sub-paragraph (b)(i) provided that such intermediate holding companies:
 - (aa) have no shareholders other than the parent company concerned or another intermediate holding company; and
 - (bb) hold no shares other than shares in a company meeting the criteria set out in sub-paragraph (a) or shares in another intermediate holding company;

and



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- (c) intermediate holding companies meeting the criteria set out in subparagraph (b)(ii).

Condition 43B. [Prohibition on Generating by Licensee]

Part A: Prohibition on Licensee engaging in the activity of electricity generation

43B.1 Except with a direction from the Authority, the licensee must not carry out the activity specified in Section 4(1)(a) of the Act.

Part B: The Direction Guidance

43B.2 The Authority will issue, and may from time to time revise, a guidance document, to be known as the [Direction Guidance], for purposes connected with the granting of directions under this Condition.

43B.3 The Direction Guidance, may, among other things, make provision about or impose requirements in respect of:

- (a) the considerations or criteria against which applications for a direction will be assessed;
- (b) the process and procedures that will be in place for the assessment and granting of a direction;
- (c) the nature of the reporting obligations on the licensee in relation to activities for which a direction has been given;
- (c) any other matter relating to the process of granting of a direction under this condition.

43B.4 Where any provisions of the Direction Guidance requires the compliance of the licensee, the licensee must comply with those provisions as if the document were part of this condition.

Part C: Procedure for issuing and revising Direction Guidance

43B.5 Before issuing the Consent Guidance under this condition, the Authority, by Notice given to the licensee, will:

- (a) state that it proposes to issue the Direction Guidance, and specify the date on which it proposes that the document should take effect;
- (b) set out the text of the Direction Guidance and the Authority's reasons for proposing to issue it; and
- (c) specify the date (which must not be less than a period of 28 days from the date of the Notice) by which representations with respect to the proposed Direction Guidance may be made.

43B.7 The Authority will consider any representations that are duly made and not withdrawn.



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43B.6 The requirements of paragraphs 43B.5 and 43B.6 may be satisfied by action taken before, as well as action taken after, the commencement of this condition.

43B.7 In paragraph 43B.5, “issuing the Direction Guidance” includes issuing any revision of the document, and the procedure provided for under the paragraph will apply to any such revision.

Appendix 2 – Existing unbundling regime

More detailed description of existing unbundling regime

As a form of generation, existing unbundling requirements already apply to storage. Therefore, any network operator seeking to own or operate storage must comply with existing unbundling requirements. The requirements are currently different for distribution companies and transmission companies.

The **unbundling regime for transmission companies (TSOs)** severely restricts them from owning or operating any generation facilities.

Under the Electricity Directive, there are three models of TSO unbundling: full ownership unbundling; independent system operator; and independent transmission operator. There are specific requirements on ownership and unbundling associated with each. These requirements are transposed into Section 10 of the Electricity Act.

Under the Act, TSOs are required to hold a certification which can be granted by Ofgem, following an assessment of the TSOs business and ownership structure – the assessment looks closely at whether or not companies within the same ownership group as the TSO are engaged in activities of generation and supply. Where Ofgem deems there to be a risk of discrimination it can withhold certification.¹²

The **unbundling regime for DNOs** requires them to be *legally separate from the operation* of generation – but does not require separate ownership. This requirement is set out in Article 26 of the Electricity Directive which states that a DNO must be independent in its legal form, organisation and decision making from other activities not relating to distribution.¹³

Furthermore, Section 6 of the Electricity Act prevents the same company from holding both an electricity distribution licence and an electricity generation licence. This means that a DNO may not *directly* own or operate any generator that is required to hold a generation licence.¹⁴ This does not prevent a legally separate company within the same ownership group as a DNO from holding a generation licence.

However, Chapter 11 of the electricity distribution licence requires the DNO to ensure that any company within the same ownership group (ie any affiliate) that holds a generation licence is run independently from the distribution company. In other words,

¹² The assessment and relevant considerations are explained in detail [here](#).

¹³ The EU Electricity Directive can be found [here](#).

¹⁴ Any generator above 100MW in size



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the distribution business and the generation company must have separate management and decision-making structures, separate accounting, and legally separate form.

Under the GB framework, generators with a capacity of less than 100MW are eligible for an **exemption from the obligation to hold a generation licence**.¹⁵

Because the assessment of TSO unbundling looks at the activities of companies within an ownership group, and not necessarily the licences that are held, the licence exemptions for smaller generators have no bearing on the TSO unbundling rules.

¹⁵ Current government policy is that any generator below 50MW is automatically exempt, and generators between 50-100MW must apply to the secretary of state for an exemption.

Appendix 3 - Feedback on this consultation

We want to hear from anyone interested in this document. Send your response to the person or team named at the top of the front page.

We've asked for your feedback in each of the questions throughout it. Please respond to each one as fully as you can.

Unless you mark your response confidential, we'll publish it on our website, www.ofgem.gov.uk, and put it in our library. You can ask us to keep your response confidential, and we'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you want us to keep your response confidential, you should clearly mark your response to that effect and include reasons.

If the information you give in your response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. If you are including any confidential material in your response, please put it in the appendices.

General feedback

We believe that consultation is at the heart of good policy development. We are keen to hear your comments about how we've conducted this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send your comments to stakeholders@ofgem.gov.uk