

Andrew White
Energy Systems Integration,
Ofgem
9 Millbank,
London,
SW1P 3GE
flexibility@ofgem.gov.uk

Centrica plc
Millstream East
Maidenhead Road
Windsor
Berkshire SL4 5GD

Telephone 01753 494000
Facsimile 01753 431010
Website: www.centrica.com

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Dear Andrew,

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

Centrica supports Ofgem's proposal that Distribution Network Operators (DNOs) should be prohibited from operating storage. However, we believe that Ofgem should go further and also prohibit DNOs from owning storage.

We agree with Ofgem that for "*competitive activities...carried out by monopoly network operators, there is potential for competition to be distorted*". We share this concern and believe that such distortions can be minimised by prohibiting the operation and ownership of storage by DNOs. There is sufficient competition in the storage industry, to ensure that the procurement of flexibility services, through market-based competitive processes, will be liquid enough to bring forward cost-effective solutions.

Centrica accepts that in some exceptional circumstances, DNO ownership or operation of storage may be required. We believe that these cases must be clearly defined in the Electricity Distribution Licence guidance documentation and that each exception must be granted by Ofgem for a limited time. Such exceptions must only be granted if all market-based solutions have been explored and that such solutions demonstrably do not exist or are not cost-effective.

Distribution Network Operators should be compelled to provide as much transparency, accounting for commercial and confidential limitations, to industry regarding its current and future flexibility needs. The transparency will drive competition and innovation in technologies that could provide such services.

Please find below the detailed responses to the consultation questions. Please do not hesitate to contact me, if you would like to discuss any points raised.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Jack Abbott
Regulatory Manager, Wholesale Electricity Markets
07557 615 587
Jack.abbott@centrica.com

Centrica response to the consultation questions

Chapter 2

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?

Centrica supports Ofgem's proposal to amend the Electricity Distribution Licence to clarify that DNOs are prohibited from operating storage of any size, except for specific named exceptions. These potential exceptions are discussed in detail in questions 3 and 4 of this chapter. We believe that competitive, market-based mechanisms must be encouraged to ensure lowest cost to consumers and to encourage innovation.

However, we believe that Ofgem should go further now and prohibit DNOs from owning storage; this would be in line with their view outlined in the BEIS/Ofgem Smart Systems Flexibility Plan and the expected end goal for DNO unbundling, as outlined in this consultation. Unbundling of operation and ownership of storage by DNOs is consistent with the European Commission's (EC) Clean Energy Package, specifically, the proposal within the revised Electricity Directive (COM(2016)864), Article 36, paragraph 1, that states: *"Distribution system operators shall not be allowed to own, develop, manage or operate energy storage facilities"*. Unbundling ownership of storage would be consistent with the facts that DNOs cannot directly own or operate large-scale storage over 100MW; and that Transmission Owners cannot directly own or operate storage assets.

By delaying the unbundling of DNO ownership, DNOs may, in the short-term, build and own storage assets, with their operation delivered by a legally separate entity of the DNO. The number of storage assets affected by further unbundling will be higher than if the unbundling was implemented immediately; likely resulting in Ofgem having to grant derogations and exceptions, which could introduce long-term distortions to the market.

We note that in the drafting of Condition 43B, it refers to generation assets, rather than addressing storage, in particular. We believe that it would provide clarity to use the same terminology as suggested in the parallel Ofgem consultation 'Clarifying the regulatory framework for electricity storage: Licensing'. Therefore, we suggest that Condition 43B refers to *"electricity generation– including a storage facility"* to ensure clarity.

We support Ofgem's view that DNOs will need to become more active in managing their networks as a system; implementing innovative techniques and exploring market-based solutions as alternatives to network reinforcement. The goal of a Distribution System Operator (DSO) is to operate the distribution system in a secure and cost-effective way, and for such, system needs will need to be clearly communicated in advance. Flexibility services may be provided by storage assets which must be procured competitively via the market; these services may be procured to resolve local balancing issues, or to displace costly distribution-level infrastructure.

We do not believe that the DSO role should be conducted by the DNO; we believe it would be best for the DNO and DSO to be completely independent from the outset, rather than the DSO role automatically granted to the incumbent DNO. This would ensure that there are no

conflicts between the decision making on investments and the physical provision of infrastructure.

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?

The principles for DNOs should apply to IDNOs.

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?

Centrica has generally been of the view that there should be no exceptions to DNOs directly owning or operating storage assets. However, we accept that there are existing arrangements for emergency response and uninterruptible power supplies (UPS), and it may be acceptable for operation and ownership of these to remain under the DNOs. Ofgem must assess these existing arrangements, to ensure that a market-based approach would not be more efficient and cost-effective, before allowing these arrangements to continue; the conclusions and Ofgem's reasoning should be clearly communicated to industry. The reasons for which exceptions can be granted to DNOs to allow them to operate and own storage, must be explicitly stated in the guidance document and regularly reviewed.

For future arrangements, we believe that DNOs should procure (both the ownership and operation of) these assets commercially via a market-based process and would require explicit approval (on a case-by-case basis) from Ofgem if unable or uneconomic to do so; this should be clearly defined in the licence condition guidance document. Market-based procurement provides opportunities to market participants to provide solutions to lower the cost of maintaining the Distribution Network.

We do not agree with the inclusion of the following clause in the guidance document: *“Very limited number of exceptional circumstances where [Ofgem] might consider it acceptable for DNOs to operate storage directly”*. The guidance document should identify, through consultation with industry, the specific exceptions where DNO ownership or operation of storage could be acceptable (e.g. for UPS and islanded generation).

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?

Ofgem should investigate and clarify the amount of islanded system generation currently owned by DNOs, to provide transparency to industry.

Ofgem should remove operation of existing islanded generation and storage and tender this operation to the market; there would need to be a specific reason why the DNO must continue to operate the storage, rather than another operator. If the DNO should continue to operate this storage, Ofgem must approve on a case-by-case basis and publish its rationale.

Ideally, the ownership of existing islanded generation should be removed from the DNO, although Ofgem would need to consider whether it is cost-effective to do so.

For future arrangements, DNOs should look to procure (both the ownership and operation of) these assets commercially through a market-based process and would require approval from Ofgem if unable or uneconomic to do so; this should be clearly defined in the licence condition guidance document.

Chapter 3

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?

The three criteria proposed are sensible core criteria. We believe that the first criterion is crucial, as we believe that a market based solution will, in general, provide an efficient outcome; there would need to be demonstrable evidence to the contrary.

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

Firstly, we accept that when there is clear legal separation of operation of generation or storage from the DNO, an exception is not required. However, in line with our position that DNOs should not own storage or generation, this exception should be amended to state *“legal separation of operation and ownership”*.

Ofgem should have a stringent and clearly defined assessment process to ensure that a legally separated entity to a DNO owning and operating storage and generation, is not provided any advantage if the ultimate parent company is the same as the DNO. We support the need for robust business separation rules, as outlined in the Distribution Licence.

Centrica believes that for specific named activities (namely uninterruptible power supplies (UPS), emergency response and maintenance, and Islanded generation), the DNO would need to apply for a specific consent from Ofgem.

We do not agree that Ofgem should include the circumstance under 3.7, which states that the DNO could apply for an exception for any other reason. We believe that all exceptions should be specifically named and must gain an exception from Ofgem. If Ofgem or DNOs believe that an exception should be included as a specific named activity, there should be a route by which this can be added, following consultation with industry. We believe this should apply for ownership and operation.

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

The process proposed in the consultation is sensible.

Chapter 4

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

Where a DNO contracts commercially for flexibility services provided by an independently owned and operated storage provider, we agree that there would not need to be oversight of such arrangements, although - as Ofgem states - these should be procured in an open and transparent way.

For the rare occasions that DNOs operate and own storage, DNOs should be required to report and justify their usage, as well as any associated costs. This will allow Ofgem to easily audit any behaviour and identify any anti-competitive behaviour. This will also provide opportunities for industry to identify lower-cost solutions.

**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?**

We believe that DNOs should be as transparent as possible, after accounting for commercial and confidentiality requirements, of the services that they are procuring to encourage increased market competition. DNOs should signal where investment is needed to ensure the safe, secure running of the network, providing opportunities for the market to deliver alternative solutions to network reinforcement.

Providing transparency to industry of future system needs, will enable market investment to meet these needs; this visibility to industry should avoid market failure resulting in DNOs needing to own and operate storage. DNOs should ensure that their Heat Maps (which are of differing levels of quality anyway) highlight where constraints are physically situated on the system, so that storage operators can identify the best locations for siting storage.

**Centrica
November 2017**