

Jonathan Brearley  
Executive Director Systems and Networks  
Ofgem  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU

22<sup>nd</sup> August 2018

Dear Jonathan,

**RE: Separation of Commercial Operations of Distribution Network Operators**

Energy UK, the ADE, Renewable UK and the Solar Trade Association are supportive of actions being taken to transition the UK to a smart flexible energy system, including the deployment of controllable network assets and enhanced network monitoring capabilities across UK networks. Investment in these technologies will not only enhance optimal network management and transparency but will aid in efficient future operation of both the national energy system and energy markets to the benefit of consumers.

Recent activities from a number of Distribution Network Operators (DNOs) have resulted in concerns from across the energy industry about the effectiveness of roles and scope of regulated activities in preventing market distortions as the energy system transitions. In particular, concerns have been exacerbated by the recent participation of a DNO in bidding into - and subsequently being awarded - ancillary service contracts.

As such, Energy UK, with support from the ADE, Renewable UK and the Solar Trade Association, would ask that Ofgem: Firstly, review the DRS8 decision allowing all DNOs to recover uncapped revenue from participation in competitive markets and, secondly, begin a consultation process to review the regulatory treatment of regulated assets providing ancillary services to the System Operator and/or DNOs or DSOs. This should include re-examining the cost benefit analysis justifying the decision, as well as exploring the impacts of these activities on both local and national customers and markets in the context of a transitioning energy system.

These actions will help to ensure that DNO activities are (1) appropriately focussed on optimising the operation of their network to achieve the best outcome for GB consumers and (2) not negatively impacting upon the efficiency and competitiveness of UK energy markets.

Our concerns can be broadly categorised into three areas.

**1. Market Facilitation**

- DNO participation in ancillary services markets is contrary to the existing and ongoing work of Ofgem and the EU in market design regarding regulated network operators participating in commercial activities. Any activities misaligned with this position should, therefore, only proceed if deemed appropriate under a comprehensive consultation process with a clear and proven consumer case and significant care taken in regulatory treatment to mitigate risks.
- By allowing DNOs to recoup revenue beyond original innovation investment through DRS8, as opposed to the small margins allowed by DRS9, Ofgem is potentially enabling double-payment, to the cost of consumers. This would have and, in the case of existing contracts, is already having an adverse effect on competition. Unconstrained bidding will distort the market and potentially materially reduce consumer benefits.
- Market participation utilising regulated assets risks market distortion. Established business models and plans, based upon competition and incorporating revenue from ancillary services, are not based on the expectation of competing with regulated monopolies and will continue to be heavily impacted if DNO participation continues.
- Where DNOs become active market participants under existing arrangements, these markets are no longer truly competitive. This could impact on system security by taking away market share and reducing the number of active market participants.

**2. Collateral Risks to Optimal Network Operation**

- Energy UK fully supports innovation through increasing the controllability of network assets for the purpose of increasing optimal network operation. Where it is economically efficient for a DNO or TO to undertake activities to optimise network operation the RIIO price control framework should be designed to ensure appropriate compensation.
- DNO participation in competitive markets results in a conflict of interest, as the successful development of competitive markets would remove potential revenue for the network operator.
- The use of network assets for purposes other than their intended role in network operation should be transparent and only be allowed where there is a clear consumer benefit and where it has been demonstrated that there is no detriment to system performance. Participation in ancillary services may prevent the voltage control asset from operating in its intended role and prevent consumer benefits, including reductions in network charges, being realised from assets which consumers have paid for.

### 3. *Innovation Outside of Licenced Activities*

- The use of innovation funding to invest in and develop services outside of licenced activities is documented across a number of networks, particularly in terms of the ownership and operation of energy storage.
- Energy UK understands the benefits of DNO innovation efforts to lower overall costs to consumers. The continuation post-trial of any activity outside of the optimal management and maintenance of the network, as set out in licencing, is a break from the intended role of the DNO.

Additional activities outside of those taken into account by existing unbundling principles are commonly called upon in this discussion, including 1) the operation or ownership of storage, the latter of which is yet to be prohibited, 2) DNO or subsidiary organisations' participation in competitive markets, and 3) reaching beyond the smart meter to control consumer loads, moving DNO activity beyond existing borders, as is proposed in a recent Modification Proposal for the Smart Energy Code (SECMP0046).

These activities have the potential to heavily impact upon the continued competitiveness and success of the UK's energy markets at a critical time in the transition to a smart flexible energy system. It is, therefore, vital to address the lack of clarity surrounding roles and activities of network companies as soon as possible to prevent further distortions or continued damage to market confidence.

It is important to ensure that, moving forwards, proposals for changes to DNO roles or activities be aligned with anticipated measures contained in the European Clean Energy Package and recommendations from the Council of European Energy Regulators (CEER), including that "DSOs must act as neutral market facilitators in the flexibility market performing regulated core activities and not activities that can efficiently and practicably be left to a competitive market".

I would express both Energy UK's and our members' gratitude in the open approach of DNOs in sharing information on innovation projects and other ongoing areas of operation. Energy UK is grateful for the opportunity to meet bilaterally with Electricity North West (ENW), as well as hosting a workshop at which Energy UK members were able to directly engage with ENW.

I welcome the opportunity to discuss the matters outlined in this letter and feel that an open dialogue with a wide range of stakeholders on the roles and activities of DNOs is warranted.

Yours sincerely,



Lawrence Slade  
CEO, Energy UK

CC: David Capper, BEIS; David Smith, Energy Networks Association; Peter Emery, Electricity North West



With the support of:

A handwritten signature in black ink, appearing to read "Tim Rotheray".

Tim Rotheray, Director of the ADE



A handwritten signature in black ink, appearing to read "Maf Smith".

Maf Smith, Deputy Chief Executive, Renewable UK



A handwritten signature in black ink, appearing to read "Chris Hewett".

Chris Hewett, Chief Executive, Solar Trade Association

