

Early Competition Plan

Phase 3 Consultation: Chapter 7, Early Competition in Distribution -
Potential ESO role in ED2 early competition

December 2020



Contents

1	SUMMARY	3
2	APPROACH AND ASSUMPTIONS	4
3	DISTRIBUTION EARLY COMPETITION ROLES AND PROCESS	6



1 Summary

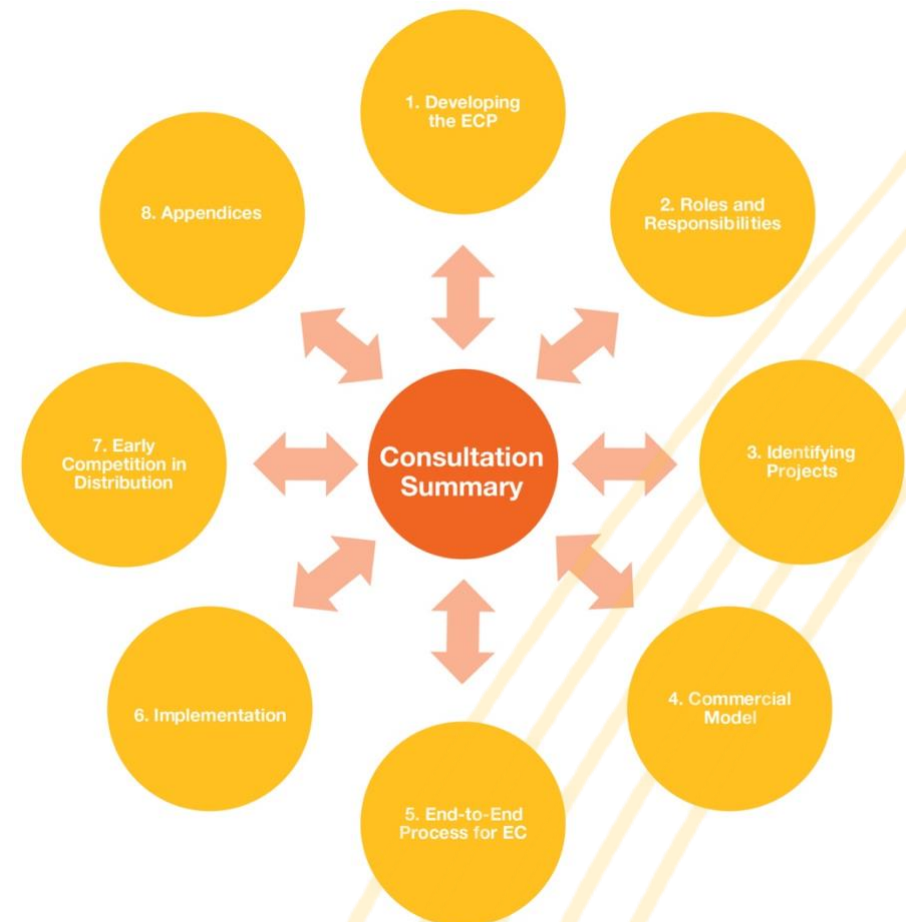
While the primary focus of the Early Competition Plan is on transmission needs, Ofgem are in the process of making the decision of whether to include early competition in the electricity distribution sector as part of RIIO-ED2, due to start in 2023.

While developing the roles required to support early competition at a transmission level, Ofgem have also asked the Electricity System Operator ("ESO") to consider what role it could play in supporting early competition in the electricity distribution sector from 2023. Areas to consider suggested by Ofgem include auditing and running and/or assessing the tender process.

One output of the Early Competition Plan will be an ESO thought piece on this subject. It will set out a range of options and considerations that could inform Ofgem's thinking in relation to early competition for RIIO-ED2.

In this chapter we are seeking stakeholder feedback on:

- The application of the proposed process and roles to distribution needs
- Views on which parties may be best placed to perform required roles
- Views on potential additional roles and which parties may be best placed to perform them



2 Approach and assumptions

This section sets out our approach and assumptions used to develop our thinking on the topic of the potential role(s) of the Electricity System Operator ("ESO") in distribution sector early competition. We did not cover this topic in our Phase 2 consultation because it was felt that it would build on the work done for transmission level early competition.

Our approach to the request from Ofgem is to work with stakeholders to establish at a high level:

- 1) Could the process steps and activities developed for the transmission level model of early competition be applied to distribution needs?
- 2) Whether the key roles required to support early competition are the same for both transmission and distribution?
- 3) Whether there are potentially any additional process steps or roles that could be useful?
- 4) What are the key advantages and disadvantages of each party performing a role where they have been identified as an option?
- 5) What are stakeholder views on who might be placed to perform the roles?

To develop our thinking in this area we have used the following key assumptions:

- The same model for early competition would apply for both transmission and distribution needs
- Where there is a common role, the ESO will only consider performing a role at distribution sector level that it is performing already at transmission level
- We don't confine the thinking on roles to only those supporting the transmission level model of early competition
- The ESO should only be considered as a possible Third Party option (a Third Party being an institution, new or existing, not traditionally involved in distribution)
- The nature of institutional structures for ED2 is not currently known, other than Distribution Network Owners ("DNOs") may take

on additional Distribution System Operator ("DSO") activities. We have assumed that current business structures will remain in place during ED2, and

- The decision to implement early competition at distribution level is led by Ofgem as part of ED2, and Ofgem will decide how to conduct any deeper review of institutional arrangements.

Aim of consultation

In order to understand what role there could be for the ESO in supporting distribution level early competition, we are seeking additional stakeholder views on whether there is a strong case for Third Party involvement, or whether existing institutions are a natural fit. We would like stakeholders to provide views on the relative advantages and disadvantages of the options, and to indicate their preferred option for which party they feel is best placed to perform a role.

The decision on whether early competition at either level is in consumer interest sits with Ofgem. We are not seeking stakeholders' views on whether early competition should or should not be implemented into distribution. For the purpose of the following sections it should be assumed hypothetically that Ofgem have decided that early competition will be implemented into distribution.

Stakeholder engagement

The options, views, advantages and disadvantages set out in the following sections have been developed through engagement with stakeholders. In September the ESO ran workshops with the Energy Networks Association ("ENA") Over Arching Working Group on ED2 Competition ("OAWG ED2C") to seek views from the DNO community.

At the beginning of October, we also ran two webinars seeking views from all interested stakeholders. It should be noted that there was an equal split in numbers between DNO and non-DNO stakeholder organisations which chose to participate in the webinars.

Strive for fair stakeholder representation

To encourage distribution focussed stakeholder engagement, we ran targeted workshops via the Energy Network Association. This was in addition to our wider programme of workshops and Ofgem signposting the work being done in the ED2 Sector Specific Methodology Consultation.

3 Distribution Early Competition Roles and Process

In the following sections we will cover the application of the process being developed for transmission level needs to distribution, the key roles developed to support this process and lastly, ideas on potential additional roles that could support early competition at distribution level. In each section we will set some detail, the options to be considered and a summary of the stakeholder views that we have heard so far.

3.1 End to End Process

The key roles associated with early competition for transmission needs are being designed to support the process. Our starting point has been to consider whether the high-level process set out for transmission level needs could be applied to distribution level needs.

An outline of the key process steps and activities can be found in the [Consultation Summary](#), [Chapter 3 Identifying Projects](#), [Chapter 4 Commercial Model](#) and [Chapter 5 End to End Process](#).

End to End Process



Stakeholder feedback

Stakeholder feedback has not indicated any major incompatibility issues at distribution level, if the high-level end to end model set out in the Phase 2 consultation was to be applied. What was confirmed is that there would have to be modifications at a more detailed level to reflect the differences between the transmission and distribution sectors. It would not be possible to simply adopt an exact copy of the process used for transmission needs to address distribution needs.

Some key themes heard from stakeholders so far are:

- The tender process being proposed for the transmission level needs does not appear to create any issues. It appears to follow a similar approach to standard procurement practice in the distribution sector, and has elements common to Utility Contract Regulations 2016 ("UCR"), which the distribution sector already operates against

- The application of criteria to determine whether a need could be suitable for early competition could work. However, the criteria would need to change to reflect the shorter timescales, lower value and potential impact on multiple customers traditionally associated with distribution network needs
- Network Planning at distribution level could support the project identification process as it does identify future needs. However, it does not currently use the same processes as transmission e.g. Network Options Assessment ("NOA")

Preferred option

Our current position is that the key process steps and activities could work for distribution.

Questions

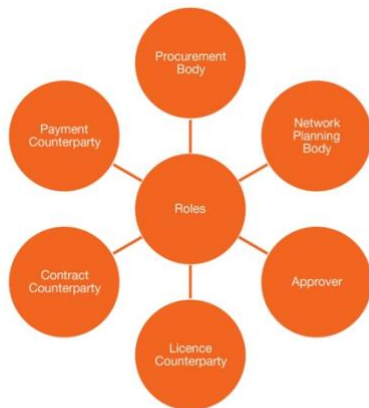
1. Is there an issue with the high-level early competition process being developed that means it could not be used for distribution sector needs? If yes, please specify the issue(s) and why they make the process unusable.

3.2 Key roles

This section considers which parties may be best placed to perform the key roles identified to support the early competition model.

Table 1 sets out the key roles and options being considered for which parties could perform them. The options generated are based on the logic applied for the transmission level early competition model. For more detail on the roles please see Appendix A, and Chapter 2 Roles & Responsibilities

Table 1: Roles and Options



Role	Options		
Procurement Body	ofgem	DNO/ DSOs	
Network Planner		DNO/ DSOs	
Approver	ofgem	DNO/ DSOs	
Licence Counterparty	ofgem		
Contract Counterparty		DNO/ DSOs	
Payment Counterparty		DNO/ DSOs	

3rd party

Assumptions for ED2:

- Multiple integrated Distribution Network Owner ("DNO")/Distribution System Operator ("DSO")– business structures as of 2020
- All DNOs would be able to participate in early competition against other bidders
- Higher volume / lower value of projects at distribution level
- Early competition being run for transmission needs
- Third Party could be a new party, the party performing the role at transmission level, or the ESO

Stakeholder feedback

A significant proportion of the stakeholder feedback received so far has been from DNOs. A table of key advantages and disadvantages of each of the options for parties to perform roles can be found in Appendix B. These were initially developed and tested by the ESO with the ENA OAWG. They were then further developed and tested in the October webinars which were open to all stakeholders and did include non-DNO stakeholders.

Procurement body

Stakeholders have expressed very strong support for this role to sit with the DNO/DSO. Strong themes heard in support of this position is their experience of running competitions already, their in-depth knowledge of the multi voltage networks, and that they are best placed to react quickly to customer needs in an environment that traditionally works to shorter timescales than transmission. The perceived complexity and cost of introducing Ofgem or a Third Party to this role is seen as a very significant disadvantage by nearly all stakeholders alike.

Non-DNO stakeholders expressed some concern that there could be a conflict of interest if the DSOs in ED2 are an integrated DSO/DNO, with the DNO arm taking part in the competition. However, it was generally acknowledged that the future relationship between DSO and DNO is not known at this point. There was also a view expressed that due to the perceived complexity and cost of the other options, the risk of a conflict of interest could be better mitigated by Ofgem strengthening the regulatory regime the DNO's operate within.

For the transmission level process our preferred option is being developed. Please see [Chapter 2 Role & Responsibilities](#) for more details

Network Planner

Stakeholders have expressed very strong support for this role to remain with the DNO/DSOs. The key theme from all stakeholders is that distribution network planning is currently a core activity of the DNOs and is very different to transmission level. The modelling, needs drivers, timescales, assets, topography and multi-voltage nature would make the transfer of this role to any 3rd party extremely challenging and costly.

For the transmission level process our preferred option is that there is minimal change to the current state which involves the ESO and TOs working together on network planning. The stakeholder views in support of the DNO/DSO can be considered broadly equivalent of our preferred option for transmission, in that they are proposing to maintain a similar current state.

Approver and Licence Counterparty

Stakeholders have expressed extremely strong support for these roles to sit with Ofgem. This reflects the preferred option at transmission level. Key themes are that as the Approver, Ofgem are best placed to provide a strong voice for consumers and build trust in the process. The role of Licence Counterparty naturally sits with Ofgem as only they have the power to award a Licence.

A view was expressed that while it made sense for Ofgem to be the approver, there could be an opportunity to consider whether some form of independent audit of Ofgem decisions would be reasonable.

Contract Counterparty

Stakeholders have expressed extremely strong support for DNO/DSOs to take on this role. The key message from stakeholders is that the Contract Counterparty should be the holder of the operational risks associated with the provision of the service, as is the case today for DNOs. If this is not the case, a concern raised was it creates a disconnect between the party responsible for provision of the service and the party who is accountable to consumers and the regulator for issues created by a failure in the service. This is broadly like our preferred option for the transmission level process, which is for the ESO to perform this role. Please see [Chapter 2 Roles & Responsibilities](#) for more information.

Payment Counterparty

Stakeholders have expressed extremely strong support for DNO/DSOs to take on this role. The key messages so far have been that DNOs currently perform a similar role already and there does not appear to be an issue with the DNOs continuing to perform this role, if it is expanded to include the activities to support an early competition model. The role requires an expert understanding of the relevant charging regimes which would require significant effort to transfer to a 3rd party. Given that it is a largely transactional process some concern was expressed that it could be difficult to find an interested party to take on the role.

Our preferred option for the transmission level process is for the ESO to perform this role. The stakeholder views supporting DNO/DSO can be

considered broadly the same. Please see [Chapter 2 Roles & Responsibilities](#) for more information.



Keep our stakeholders in the know

We hosted dedicated workshops in October for ESO Role in Distribution Early Competition to give stakeholders the best opportunity to focus on this area.




Questions


2. Which party is best placed to perform each of the key roles at distribution level? Where 3rd party is chosen please specify who you think this could be and why?

3.3 Additional roles

To fully explore the question of whether the ESO may have a role in supporting early competition in the distribution sector we have explored with stakeholders' ideas for additional roles that may create value for consumers. We created an initial list for discussion with stakeholders and asked for feedback. Table 2 sets out an outline of potential roles and options.

Table 2: Additional roles

Role	Description	Options
Best practice coordinator	Set out, standardise and improve process used by all parties	  
Auditor	Monitor consistent application/compliance of process across all parties	
Project consolidation	Identify opportunities to bundle projects across networks	
Whole system review	A check to look at whether with minor changes to planned work on transmission or distribution network, a proposed competition is not required	

 3rd party

Stakeholder feedback

Overall, stakeholders so far do not support the creation of the additional roles outlined. Generally, the feedback has been that there may be some value in these roles, but that existing mechanisms can accommodate the activities and are the preferred option.

Best Practice Co-ordinator

Some common themes we have heard are that Ofgem is best placed to use their influence to create improvements across distribution sector processes and that it is difficult to see how a Third Party could be as effective. Other views were that regulatory regimes such as UCR effectively set standards, and that there are already examples of industry sharing knowledge. The ESO working with distribution stakeholders to share knowledge on flexibility services and RIIO2 plans for supporting development of a distribution NOA were cited.

Auditor

Stakeholder views focussed on existing mechanisms with very little support for creating a new role in this area. Some stakeholders said that the purpose of existing internal audit and compliance functions already fulfil this role. Others added that with Ofgem in the Approver role this should provide a level of assurance that the processes were being well run. Where there was a view for a Third party, the National Audit Office was suggested as an existing expert in this area that could audit the process.

Project consolidation

Stakeholders focussed on existing mechanisms with very little support for creating a new role in this area. Stakeholders highlighted that networks are already required to demonstrate efficient planning of their project portfolio to Ofgem. A few stakeholders expressed the opinion that joint procurement activities would be extremely complicated and unlikely to significantly enhance value delivery, compared to separate events. They also raised concerns that this might conflict with their Licences and UCR.

Be consistent, whilst remaining flexible

We have strived to keep presentation materials in the same format, so that stakeholders can see the development process. The original material to support discussion of additional roles with the ENA working group didn't work. So, we amended them upon feedback, and arranged additional sessions.

Whole Systems Review

There was very little support expressed for the creation of a role in this area. A clear theme from most stakeholders is that Ofgem through ED2 and RIIO-2 are already creating strong direction and focus in this area. Another view expressed is that this a behaviour of existing parties rather than a role that could be performed by a Third Party.



Be transparent where possible

As well as co-creating the key advantages and disadvantages of options with stakeholders on key roles, we are exploring additional roles outside of traditional remits.

Questions

3. Should any of the additional roles be created as specific roles? If yes, please set out who you think is best placed to perform the role and why.

Next Steps

Thank you for taking the time to read this chapter of our Phase 3 consultation. We look forward to receiving your feedback which will help inform the final version of the Early Competition Plan. For full details on the range of options on how to respond, please refer to the [Consultation Summary, Section 8](#).