

Ofgem's call for input on Future of Local Energy Institutions and Governance

Northern Powergrid Customer Engagement Group's response

Introduction

We welcome the opportunity to respond to this consultation which addresses issues that are of real importance to all members of our society, whether or not they are current electricity customers.

As an independent Customer Engagement Group our role is principally to scrutinise the work of Northern Powergrid to ensure that it is conducted in the best interests of its customers and stakeholders. But in view of the importance of the issues raised in this consultation for this same group of people we want to offer our views to Ofgem for consideration in its policy development. It is important to be clear that the views in this document are our views as a CEG and do not purport to represent the collective views of Northern Powergrid's customers and stakeholders.

Overarching Points

The issues raised in this consultation are wide ranging and could potentially have profound consequences for how consumers' needs are met in future, and how the substantial benefits available from decentralisation of generation and digitalisation of the electrical system are realised and shared. We would like to make three overarching points before addressing Ofgem's specific consultation questions.

Protecting customers'/citizens' interests: In any consideration of change to local institutions and governance we believe that the protection of customers' interests should be afforded the highest priority. This applies not only to their direct economic interest in keeping the cost of energy and services as low as practicable but also to their wider interests of being able to trust the new arrangements to be equitable, attuned to local needs and priorities, and agile enough to respond appropriately as those needs and priorities change over time. All of these aspects will be critical to achieving the level of 'buy-in' from citizens necessary to achieve the transition to net zero on time, and they have important implications for the design and governance of the institutions: the arrangements need to be transparent, open to public scrutiny, and accountable locally as well as nationally.

Consideration of the broader functional context: The functions identified in the consultation are those usually included within the definition of DSO, but their effective discharge needs to be considered within the wider context of the broader energy systems and planning functions. This includes, for instance, the functions associated with the stewardship of distribution network assets (planning, procurement, maintenance, development, etc). It also includes the overall energy market, as this provides the context within which the value of flexibility is determined. Importantly, it also includes spatial and broader regional planning which is so inextricably linked with energy market needs and opportunities. A critical

consideration for any proposed change is whether or not it will improve the coordination between energy system and local/regional spatial planning.

Timing of institutional change: Fundamental changes will take years of legislation and consultation on regulatory changes and, as the document recognises, could potentially become a distraction from other urgent priorities. So it is important to identify and pursue other changes in the short term which are deliverable within the existing institutional framework and pursue those vigorously. This is particularly important in view of the current cost of living crisis combined with the urgency of making progress towards net zero. Such an approach does not foreclose on options for more fundamental change. On the contrary it provides a window of opportunity to improve our understanding of the drivers of effective incentives at distribution level, and to take a fundamental look at the broader market and institutional and governance structures that will take advantage of emerging opportunities (such as improved data, and digitalisation) and be best suited to citizens' future needs. Such an approach will also facilitate the development of effective mitigations for the significant implementation risks associated with institutional change.

Responses to specific questions

1. *Are the three energy system functions we outline (energy system planning, market facilitation of flexible resources and real time operation of local energy networks) the ones we should be focusing on to address the energy system changes we outline?*

These functions provide a reasonable focus. But we should also explicitly consider stewardship of network assets (ownership, development and maintenance) as a separate function, as these three system functions clearly interact closely with it. If we don't consider this fourth function explicitly, we risk creating structures with fuzzy communications and accountability across planning, operations and asset development.

The functions also need to be scoped more broadly – for example, energy system planning needs to be placed firmly into the context of broader regional planning; and flexibility markets need to be seen as an integrated part of a wholistic energy market, not partitioned off separately into a series of sub-scale markets as they currently are.

2. *Do you agree with the criteria we have set out for assessing the effectiveness of institutional and governance arrangements?*

The criteria outlined are reasonable, but they are incomplete. As per the discussion above, we should also be considering factors such as:

- Transparency
- Inclusion
- Agility

Accountability also needs careful consideration: while there needs to be clear accountability to national bodies for compliance with their agreed requirements, there also needs to be unambiguous accountability to local stakeholders for compliance with their agreed requirements. So accountability is multi-faceted and needs to be clearly established and reported on. (NB There is a link between this point and the

final bullet in our response to question 10: establishing strong local institutional accountability will help to redress the shortcomings of traditional consultation processes in capturing the views of ordinary citizens).

It also needs to be recognised that, while simplicity is an important criterion, the arrangements need to be *“as simple as possible and no simpler”*. We are dealing with complex issues. Over-simplification won't serve us well.

3. *Do you agree with our assessment of how far the current institutional arrangements are, or are not, well suited to deliver the three key energy system functions?*

Broadly. Although heat and transport are appropriately mentioned in the scope of call for input, the analysis focuses almost exclusively on electricity infrastructure and its operation (and even just considering electricity there seems little coverage of the accompanying market development and its governance). The roles of suppliers and aggregators are not explored.

There is a much bigger issue of coordination of flexibility markets, encompassing all forms of flex and all potential markets for it, than is discussed here. This is a major barrier to realisation of the full value of flexibility, and needs to be addressed.

On the additional criterion of agility, it has to be recognised that the current arrangements fail pretty dismally. They are also weak on inclusion – there is a degree of inclusion via involvement of local authorities and suchlike, but they have limited influence of decision making and very limited access to the data and expertise needed to give them a meaningful say.

Also not considered are the roles and responsibilities of manufacturers of customers' smart equipment. Such equipment presents the de-facto behaviour of a sizeable part of the energy system and any future framework for energy governance needs to recognize this. This should also include the roles and responsibilities of other relevant third party providers such as providers of communication infrastructure. The issues identified are all real.

4. *Overall, what do you consider the biggest blocker to the realisation of effective energy system planning and operation at sub-national level?*

Lack of clarity of shared objectives and accountability. Accountability and expertise are scattered across numerous bodies with no clear remit to coordinate. Data to underpin such coordination is lacking (or at least of dubious quality, timeliness, openness, etc).

One specific point which illustrates this lack of shared objectives and accountabilities, that has become increasingly apparent during the preparation of DNOs' business plans for ED2, is the weakness of the current arrangements to ensure mutual consistency between spatial and energy system plans. The requirements here are radically different from those of a few years ago because of the need to plan and implement the transition to net zero. The weaknesses stem partly from the variability (and general shortfall from the necessary level) in the capability of local planning authorities to engage effectively with energy system players. But they also reflect the lack of focus and resource on this issue from

energy system players. Any changes must recognise and contribute to addressing the weaknesses of the current arrangements.

5. Do you agree with the opportunities of change we outline and the potential benefits they may create?

The benefits of synergy are reasonable. There are, potentially larger, benefits of citizen engagement and development of more customer/consumer-centred products and services that are not addressed at all, but which could be fundamental to achieving Net Zero, as discussed above.

But when considering the opportunities it is also important to consider the risks and potential downsides of change, and to adopt strategies that effectively mitigate the risks and manage the downsides proactively – our overarching comments are relevant here.

6. Are there additional opportunities for change and benefits that we have not set out?

Yes – as per question 5. In addition to this it may be worth considering a challenge to the basic structure of the industry as laid down in the '89 Electricity Act. Why does it remain appropriate to formally split the industry into only generation, transmission, distribution and supply? Why do transmission and distribution need to be separately defined? Do the roles of aggregators and others not merit a rôle? And is licensing, as defined in the '89 Act (which includes domestic customers with PV as generators within its scope) still an appropriate model? Note the comments in Q3 re manufacturers too. Why, if net zero is a pan energy challenge, is it appropriate to keep the primary legislation for gas and electricity separate from each other, and from other key energy concerns (such as transport)? The digitalization of energy would seem to provide an opportunity to create legislation recognizing a digitalized system, rather than one based solely on pre-internet technology.

7. We set out a number of risks associated with change. Do you agree with these risks and the potential costs they create? Are there additional risks of change and costs that have not been set out?

The document points out the risks of diversion of resource from other priorities, of potential delay to decarbonisation, and the relatively poor understanding of costs, incentive drivers, and opportunities at distribution level. As argued above, the combination of these factors means it is probably wise not to rush to implement institutional change now but rather to build up more experience of DSO operation within the current organisational arrangements – but within a significantly strengthened common framework.

This will also allow a more measured and detailed assessment of the risk of loss of operational efficiencies if DSO functions are eventually separated from DNOs, and how any such losses can be mitigated. One ongoing action that will certainly contribute to such mitigation is the embedding of digitalisation more firmly in the DNOs/DSOs.

8. *For each model, we have set out the key assumptions which need to be true for the model to offer the right solution. Which of these assumptions do you agree with?*

These models are valuable, but would benefit from thorough analysis before any changes are made. Some initial observations on the assumptions:

Model 1

- The assumption that effective coordination takes place between regional institutions has not so far been reliably borne out in practice. Even if the DNOs are keen to coordinate (and their ED2 plans show a reasonable degree of willingness), the other regional institutions currently lack the necessary capability, capacity and remit. At present there is insufficient traction between national energy system planning and local/regional spatial planning to ensure effective and efficient joining up of the two processes. Strengthening the interactions between these processes should be a high priority for any changes that are introduced.
- The assumption that DSO roles are inextricably linked doesn't really hold. If it did, you wouldn't be able to separate DNO from GDN or DSO from ESO. The roles are often organisationally separated within DNOs now.
- The assumption that perceived conflicts of interest can be managed purely by internal measures within the DNO is dubious – many external parties currently perceive a conflict of interest, regardless of what the DNOs say. Combining market facilitation with ownership of assets that participate in the market creates high risk of conflicts of interest.

Model 2

- The assumption that all DSO functions are interlinked doesn't really hold. A number of groups are already developing independent market facilitation functions.
- There are aspects of planning that don't currently sit within the DSO (e.g. for regional economic, transport & built environment planning), so there is no inherent reason why strategic energy system planning couldn't join them.
- The assumption that separating DSO from DNO would reduce conflicts of interest / perceptions of such conflict is reasonable.
- On coordination, the same comments as for model 1 apply.

Model 3

- The assumption that there is a case for integrating energy planning across energy vectors at regional level is valid, but too weak – integration needs to be at whole system (including transport, built environment, etc) level, not energy system level.
- The assumption that at least some DSO roles should be separated out is reasonable, as per model 2.
- There is an implicit assumption that planning, market facilitation and operations need to be closely linked. This does not necessarily hold, although the separation of the functions needs to be considered carefully and only with in depth understanding of the data requirements and flows, etc.

Model 4

- The assumption that maximising within-function synergies and assigning functions to organisations with the necessary competence is reasonable. However, this is really more a family of potential models than a single model and there will be many important detailed considerations for each specific model within the family. There is also a risk of complexity becoming a significant barrier to understanding and effective engagement.
- NB the FSO is not necessarily the right body to undertake planning or market facilitation – the former is clearly a regional function and FSO is unlikely to have sufficient regional credibility to lead it; market facilitation could arguably be national, but the ESO currently has limited skills in this area (its undoubted market development skills will not necessarily be effective for the wider cross vector and local markets which will be an important part of the future). In event, there is also a strong argument for regional markets. For example, many questions of resilience and security of supply might best be addressed at this level (e.g. storms are mostly regional events, not national ones).

9. *Out of the framework models we have developed which, if any, offer the most advantages compared to the status quo? If you believe there is another, better model please propose it.*

Our comments above make it clear that, in the long term, a model that is somewhere between models 3 & 4 probably offers the best combination of features. However, there are two very important caveats: first, any changes to local institutions and their governance should be considered in the context of the likely future energy system (and planning) landscape; and secondly the timing of any changes should be carefully considered to avoid introducing significant new risks to the timeline for achieving net zero. As pointed out in our introductory remarks, not rushing to make institutional change now will provide an important opportunity to improve our understanding of the drivers of effective incentives at distribution level and use this to inform the final decisions.

10. *What do you consider to be the biggest implementation challenges we should focus on mitigating?*

Implementation challenges are highly dependent on the specific option chosen, but there are some substantial ones that are common to most of the proposed models:

- Building institutional alignment across all the interested parties (in both energy system and local/regional spatial planning) – recognising that many of the parties are not subject to regulation by Ofgem.
- Building in the necessary degrees of agility. It's not a current area of strength in the energy system!
- Building a strategic planning body with the right mix of expertise, authority, collaborative mindset, etc, without it's becoming too large and cumbersome.
- Ownership and management of data – see Q11.
- There is a natural challenge in bringing the key stakeholders, especially energy consumers, into the debate. This is not just the logistics of ensuring that a few people “at a table” have faithfully and accurately gathered opinion

to form consensus, but because many energy issues have high technical complexity. The RIIO Customer Engagement Group process was, in our view, a significant forward step, and may provide a template for different fora, such as local energy, where infrastructure and multiple vectors (e.g. roads) are involved. (See also our response to Question 2).

In order to mitigate these and other challenges/risks it is vital that any change programme establishes clear success criteria in terms of customer/citizen outcomes up front, and that progress towards these should be monitored using a combination of qualitative and quantitative evidence. Risks associated with the change, and how they are to be mitigated, should also be explicitly identified.

11. Taking into account the varying degrees of separation of DSO roles from DNOs under framework model 1, do you consider there are additional measures we should consider implementing, in particular in the short term (e.g. changes in accountability etc)?

There would be real benefit in having a much clearer & more detailed definition of the processes and functions within a DSO, the respective accountabilities of DSO and DNO, and stronger requirements for independent scrutiny of and reporting on DSO functions.

The first aspect of this would help to clarify the implications of cleanly & fully separating some or all DSO functions from the DNO and so ensure future decisions are taken in the light of the best information possible. This would entail mapping out, for example, the data flows between DNO and DSO for data captured from an asset maintained and operated by the DNO (for which it has a strong interest in the data) but managed by the DSO in order to deliver the required network flows (which also gives it a strong interest in the data). Who pays for, owns and manages this data is currently very unclear, and without clarity on this, any attempt to separate will be highly risky. This data will also be fundamental to effective planning and market making, so we need to be much clearer about how it will be managed.

The second aspect, on accountabilities, would help for instance to clarify which body is accountable for providing what aspects of customer service (and so redress when things go wrong).

The final aspect, independent scrutiny and reporting, would provide assurance to stakeholders including potential flexibility market participants that the market is being operated in a fair and equitable manner, ie that conflicts of interest with the asset owners are being managed. This will play an important role in stimulating the development of sustainable flexibility markets.

In addition to these changes, development of flexibility markets would be further stimulated by standardisation of DNO processes and this could potentially be led by the Energy Networks Association.

12. Are there other key changes taking place in the energy sector which we have not identified and should take account of?

There's been remarkably little discussion of the needs and expectations of citizens, customers and consumers in this paper. It is clear from many other aspects of how

society is developing that these needs and expectations are changing rapidly, partly in response to the new opportunities opened up by the ongoing digital revolution. How will any new arrangements help people avoid the risks of future bill increases, failure to achieve Net Zero, etc? How will they help people to receive information and advice about available services, etc? Will any new arrangements be designed with public engagement as a core feature from the outset, rather than being bolted on as an afterthought to technocratic bodies?

Linked to this, the data and digitalization challenges, although clearly mentioned in the Call for Input, are probably under-represented in the examination of the options. Standards, frameworks and culture might all require substantial institutional effort, which cannot be discretionary.

13. What do you consider to be the most important interactions which should drive our project timelines?

We have already referred to the importance of considering the potential distractions and delays that could accompany institutional change. This, together with the potentially larger benefit of looking more broadly across the energy system and planning landscapes to ensure that a holistic and mutually supportive set of changes is introduced, suggests that timelines should be determined by interdepartmental liaison and agreement in government on implementing a new overall framework for energy.

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