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Dear Victoria,

**Call for Input: Future of local energy institutions and governance**

Transmission Investment, as one of the UK's leading independent transmission companies manages one of the largest offshore electricity transmission portfolios. We are a strong advocate of introducing competition into the delivery of transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and providing evidence to Parliament.

Transmission Investment is also leading, in partnership with the French national grid company RTE, the development of a proposed 1400MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project") and is also developing alone a 700MW HVDC interconnector between Scotland and Northern Ireland ("the LirIC interconnector").

We welcome Ofgem's Call for Input on the future of local energy institutions and governance. Many of the policy issues have strong parallels with the transmission sector, where similar challenges have been encountered to those described in the case for change. Incremental changes have occurred over 10+ years, ultimately resulting in the recent announcement of the creation of a fully independent Future System Operator, spanning electricity and gas.

In particular, we would encourage Ofgem to consider two points, borne from our experience at national level:

- Go further and faster in addressing conflicts of interest to deliver benefits of competition earlier for consumers, and
- Think big. Set out a long-term roadmap for the whole system arrangements, allowing potential blockers to be addressed early, e.g. lead-time for changes to primary legislation.

Together this will build momentum, support investment and enable framework changes to deliver benefits earlier for consumers. The industry has proven time and again how capable it is at managing change at pace, while also continuing to deliver a secure system for consumers.

We have provided specific answers to the consultation questions in the Attachment below.

Yours faithfully,



**Mark Fitch**  
Corporate Development and Regulation Manager

## ATTACHMENT: 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?

In broad terms we agree with the functions Ofgem have identified. We would encourage the market facilitation for flexible resources function to be broadened in its definition beyond commercial flexibility. For example, there could be different energy source or infrastructure solutions that could substitute for the DNO solution. This would reflect the national level, where the FSO is multi-vector and the ESO is seeking a broad range of third-party solutions: from new physical infrastructure e.g. the voltage and stability Pathfinder tenders, market-based inertia services, and, in the future, competitive onshore transmission services. It would appear prudent to set out on the journey with this in mind when developing the future governance, roles and responsibilities.

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

A critical aspect of the “credibility” criteria is whether conflicts of interest exist for the actor taking on a role. Avoiding material conflicts of interest should be explicitly stated as part of the credibility criteria, as it is a significant barrier to progress, and (in our experience) lowers investor confidence.

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?

We would agree there are multiple areas where there are conflicts of interest that will hamper the development of whole system and competitive solutions. It is clear, across all functions, that the capabilities and decision-making responsibilities need to be rearranged to align to the approach taken at a national level. Increasing the ability of third-party providers to compete with the incumbent network owner, on a level playing field, increases innovation, efficiency and ultimately benefits the consumer.

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

The biggest blocker to effective energy system planning is the conflicting interests of the incumbent network providers. While it is possible to use regulatory incentives, to better align company interests with those of the consumer, the value of these is typically small in comparison to the long-term investment returns from the networks business. As a result, the most effective way, to address the issues is to separate system planning decisions from the delivery organisation.

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

Yes, with the addition of a broader definition of Synergy 1, (aligned with our response to Question 1), to encompass wider opportunities beyond commercial flexibility competing with DNO solutions.

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

The analysis leading to the opportunities seems focussed on DNOs, however, it may result in a narrower view of the benefits of reform. This risks selecting a model that requires further change later and delays benefits to consumers and the achievement of net zero. Learning the lesson of pace of national-level reforms should encourage us to act now to create a future framework that endures to support the future for whole system planning. While it may not be possible (or necessary) to fully implement all elements immediately, the roadmap should identify longer-term changes required to institutions or the framework to deliver the solutions for net zero.

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?

While the risks highlighted are valid, these are issues that the industry has successfully dealt with through past reforms and should not be a reason to progress more slowly. Multiple fundamental industry reforms have been successfully delivered over the years, all while maintaining reliable operation of the energy systems.

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?

Model 1 – The separation of the ESO, within the same group ownership of the network owner, has proven to be unsustainable, and the independent Future System Operator is now being developed. The conflicts of interest, actual or perceived, have not been able to be managed through internal separation. Therefore, it is not a safe assumption that conflicts can be managed internally to the satisfaction of those offering alternative solutions to the network owner.

Model 2 – the assumption that the three DSO roles must remain within one electricity body is at odds with the design of the Future System Operator. The FSO is intended to be a multi-vector body, and therefore assuming these functions must remain within one electricity body is not a sound assumption. Independence of the DSO from the DNO would fully mitigate conflicts of interest.

Model 3 – the assumptions are sound and safe assumptions, because regions will have different energy sources available e.g. hydrogen clusters, which provide opportunities that can only be exploited and driven by regional bodies, focussed on maximising the use of all resources, i.e. vector agnostic. Independence of the DSO from the DNO is the only way to fully mitigate conflicts of interest.

Model 4 – while the assumption regarding focussing on functional synergies may be valid, it would appear to be based on existing bodies (including the FSO) being able, funded and capable of operating differently to deliver this, which may not be a safe assumption in the short-term (given the number of organisations that may need to cooperate and coordinate).

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.

Model 3 appears to provide the most advantages versus the status quo, including positively setting the energy sector up for the realities of the future whole system approach.

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

Industry commitment will be key in effective delivery of the changes. The industry has a strong track record of managing the risks from fundamental restructuring, however, positive incentives and time bound obligations are needed for the industry to deploy the best resources and sufficient capacity to deliver at pace.

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)?

Experience from the transmission sector has shown that Model 1, even with legal separation, the conflicts of interest remain (actual or perceived), which reduce competition and reduce benefits to consumers. Overcoming this requires full transparency of information and decisions (where the incumbent network has a role) and a level playing field in competitions (access to information, commercial treatment, separation of teams). This is ultimately only truly achievable by full independence of the system planner from the infrastructure delivery organisations.

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

The ESO proposals for reform of the energy market to use locational price signals would directly set a short-run market value for regional solutions which could fundamentally alter how localised energy challenges might be addressed.

<https://www.nationalgrideso.com/future-energy/projects/net-zero-market-reform>

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

Alignment with development of the FSO which is creating similar functions and capability the at a national level.