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## FINAL ADE Response | Future of local energy Institutions and Governance | 7 June 2022

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### **Context**

The ADE welcomes the opportunity to respond to Ofgem's Call for Input on the future of local energy institutions and governance.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 140 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

### **Overall evaluation**

On balance and noting the uncertainties, the ADE supports the introduction of either a Regional System Operator or Independent DSO as the best balance across the criteria.

Further, we believe that more can be done in the short-term to remove conflicts of interest and prepare the ground for reform. In particular, Ofgem's Minded to decision on Project CLASS exacerbates existing conflicts of interest – particularly at a time when Ofgem is also encouraging the ESO and the DNOs to share significantly more information on system operations.

Whilst we agree with the core principles and context set out in this Call for Input, it is at times too focused on the current system and the role of the DNO in dispatch and planning decisions. This review should also include some consideration of more radical changes that could be seen as we move towards operating a fully decarbonised grid (such as, for example, recent reports from the ESC and those from National Grid on future operability) as the development of these ideas moves to firmer proposals.

Further, the review could better coordinate its analysis and eventual findings with the Data and Digitalisation taskforce. There is very little in the call for input on the importance of improving data collection and use at distribution level but this is very important to efficient local energy systems.

Finally, as Ofgem review how reforming local energy governance systems can facilitate the transition to net zero at least cost, progress needs to be made in empowering individual energy users to make informed decisions about how to engage with the system. The ADE maintains its position that local solutions and local governance systems are a key part of this empowerment. High levels of consumer engagement and support will be crucial in delivering this vision and it is domestic DSR which allows consumers to take control of their energy usage, save money and lead the transition to a low-carbon society.

## Response

### **Q1. 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?**

The ADE agrees with the highlighted system functions.

However, we would note that the functions do not include network charging and its role in both energy system planning and operation of the system as well as wholesale market operations. These should be recognised as playing a role currently and it should not be assumed, as this Call for Input seems to implicitly do, that operations will be done entirely through dispatch by system operators.

### **Q2. Do you agree with the criteria we have set out for assessing the effectiveness of institutional and governance arrangements?**

The ADE largely agrees with the criteria set out. Whilst it is noted later in the Call for Input, given recent discussions regarding local actors such as Local Authorities, realistic ability to access sufficient resource should also be considered a key criterion.

Further, although it is considered under the credibility criterion, debates at Transmission level regarding the independence, and perceived independence, of the ESO over the last 5-10 years and those at Distribution over the interpretation of neutral market facilitator, mean that perceived and actual conflicts of interest should be given more importance.

Finally, consideration should also be given to communication, the extent to which that organisation can credibly and legitimately speak to stakeholders and customers, consistency on a UK level and transparency.

### **Q3. 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?**

The ADE agrees that the current governance of DNOs is not well-suited to delivering net zero at lowest cost and that there needs to be more coordination between national and local levels. Further, incentives across DNOs, Local Authorities and those developing new hydrogen, CCUS and heat networks could fit together better towards an optimised local system.

While the ADE appreciates the changes the DNOs have made, these do not go far enough or fast enough to achieve electricity system decarbonisation by 2035.

### **Q4. Overall, what do you consider the biggest blocker to the realisation of effective energy system planning and operation at sub-national level?**

From a markets perspective, the biggest blocker is currently the still relatively small volumes of flexibility being procured and other aspects related to the lack of maturity in these markets (e.g., gradual moves to standardisation, gradual shift closer to real-time etc.).

This is not helped by the different reforms underway regarding constraint management at local level where Active Network Management, flexibility markets and DUoS network charging are all currently being developed concurrently and without much overall apparent view of the appropriate interactions and overall outcome. The lack of consideration across these reforms is likely to lead to missing opportunities for each of them but also is restraining the possible liquidity of flexibility markets by splitting constraint management across, in particular, ANM and flexibility markets without clear rationale.

From an operational perspective, the poor visibility at local level and relatively basic system operation tools available to DNOs are likely the biggest blockers; noting that significant investment is likely to be provided towards network monitoring in RIIO-ED2. Further, industry experience is that the recommendations of the Data and Digitalisation taskforce are not being routinely implemented. Uptake of low carbon technologies in the retrofit market will largely be consumer-led and therefore, will be more unpredictable. Improving digitalised data collection and use will be extremely important to managing this uptake in an orderly way and more broadly, to an effective, zero carbon local energy systems.

From a broader systems planning perspective, the lack of national coordination and support for Local Authorities to undertake detailed information gathering to inform and then implement local plans is a significant blocker.

The final blocker we would note is the lack of credibility in the transformation from DNO to DSO happening in a timely way and the conflicts of interest therein.

**Q5. Do you agree with the opportunities of change we outline and the potential benefits they may create?**

The ADE agrees with the opportunities for change outlined.

**Q6. Are there additional opportunities for change and benefits that we have not set out?**

The CCC and BEIS' scenarios and ambitions suggest an increasing role for heat network infrastructure, largely heat pump-led, in the UK's urban areas. The need to plan across heat and electricity, and to use heat networks and networked heat pumps strategically to reduce reinforcement costs, is another benefit to reforming local institutions.

**Q7. 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 ADE generally agrees with risks that Ofgem have outlined, but it is worth pointing out that misaligned incentives and conflicts of interest already exist in the current system.

Further, RIIO-ED2 already requires the DNOs to separate out the DSO functions. Therefore, we consider that the risks raised by the DNOs are over-stated.

**Q8. 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?**

The ADE agrees with the assumptions set out.

Regarding the key functions set out previously, the following should also be noted –

- **Digitalisation:** Internal separation assumes that the DNOs, through a RAB price control, can efficiently and rapidly invest in significant IT infrastructure and recruit the right skills to support it. The other models obviously do not require such a strong assumption given that this could be driven by a different organisation under different incentives.
- **Market facilitation and operability:** It may be that the approach to operability is very different – for example, some recent reports have even gone so far as to suggest a shift towards asynchronous zones at Distribution. Therefore, it may be important to consider whether the DNO/DSO model in particular assumes that the geographical extent of Distribution systems planning and operation is the right one.

**Q9. 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.**

Noting that there are still many uncertainties within these models, the ADE's provisional view is that a Regional System Planner and Operator or the IDSO would be better than the status quo.

The ADE would also note that BEIS is concurrently developing proposals for "Zoning Coordinators" who will have statutory powers to collect information and then designate and enforce heat network zones<sup>1</sup>. Which institution takes on being a Coordinator is not yet determined but the assumption has been that it will be Local Authorities. It is important that this work and BEIS' work is joined up properly as it may not be efficient to separate heat network zoning functions from broader strategic networks planning across vectors.

	Accountability	Credibility	Competence	Coordination	Simplicity	Resourcing	Conflict of interest
DSO/DNO	Potentially muddled within broader price control	Legacy to overcome	Legacy to overcome	As now	Potentially muddled within broader price control	Well-resourced through price control	TBC – Could be as now
IDSO	Clear resp.	TBC - Depending on how set up, new org without legacy issues could be credible	TBC - Depending on how set up, new org without legacy issues could be competent	TBC – Explicitly part of the model but does create a new organisation with which to manage coordination	Clear	TBC – Depending on how funded (e.g., price control or through local govt budgets)	Clear
RSO	Clear resp.				Clear		Clear
Interacting orgs	Complex	TBC – Would depend upon how functions are divided up	TBC – Would depend upon how functions are divided up	Explicitly part of model	Complex		Complex

<sup>1</sup> <https://www.gov.uk/government/consultations/proposals-for-heat-network-zoning>

### **Q10. What do you consider to be the biggest implementation challenges we should focus on mitigating?**

The biggest challenges are:

- Timelines towards reaching deep decarbonisation of the power sector by 2035 and mass electrification of heat in the 2020s
- Managing costs and the inefficiencies which may arise (and may be justifiable given the greater benefits) – especially in the context of the new price control which will be settled ahead of the conclusions from this work
- Managing investor expectations and any stall on investments at Distribution level on the expectation that significant reform is coming
- Coordinating this reform with the significant number of further reforms already underway which will significantly alter local governance regarding energy; including REMA, network charging reform, the establishment of the FSO, the introduction of heat network zoning and potentially Local Area Energy Planning and the reforms to Local Government through the Levelling Up White Paper

Whilst not a challenge, it is also important that implementation of these changes flows down to standards and other work happening at the building-level; for example, the new PAS1878 and PAS1879 standards on smart appliances.

### **Q11. 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.)?**

It is clear from the RII0-ED2 business plans that UKPN has gone further than any other DNO in setting out a clear approach to full separation and avoiding conflicts of interest. The ongoing reviews of the business plans should push the other DNOs to go further on this topic.

It remains unclear to the ADE and to industry how Ofgem's minded to position on CLASS supports the long-term trajectory set out in this Call for Input and efforts in the short-term to improve coordination between the DNOs and the ESO. In particular, it is not clear why it is appropriate for the DNOs to receive further information on networks and operability from the ESO when they are themselves market participants responding to the network and operability issues the ESO is managing.

Finally, Ofgem should do more to require the DNOs going forward to publish their calculations and evidence base every time they use Common Evaluation Methodology assessments as standard.

### **Q12. Are there other key changes taking place in the energy sector which we have not identified and should take account of?**

See answer to Question 10.

### **Q13. What do you consider to be the most important interactions which should drive our project timelines?**

If the goal of decarbonising the electricity system by 2035 is to be met, then market signals need to be in place by the early to mid 2020s so that the capacity for flexibility is on the system to ensure that the system is ready for this.

Further, new institutional arrangements need to be in place to efficiently manage the phase-out of gas boilers off-gas grid, likely tighter emission regulations on non-domestic buildings in the later 2020s (through, for example, the Performance-based Ratings scheme and Private Rented Sector Minimum Energy Efficiency Standards) and potentially the growth of the retrofit market for decarbonising existing domestic homes in the 2020s and 2030s.

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**For further information please contact:**

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