

DSO Governance Team

Sent by email to: flexibility@ofgem.gov.uk

10th May 2023

Octopus Energy's response to Ofgem's consultation on the future of local energy institutions and governance

We thank Ofgem for the opportunity to respond to this consultation and generally support the problem statements that have been outlined.

We agree that, **in the long term, assigning a single entity to take on the market facilitation role is likely to achieve the best outcomes.** We also agree that **the FSO is likely the most suitable party** to take on this role. However, given the growing list of actual and potential responsibilities of the FSO - an organisation which does not yet exist - it is worth exploring which alternative parties may have the appropriate skills and competencies, such as Elexon.

However, given the importance of the work defined under the market facilitation role, it is essential we continue to make progress to standardise products and services over the coming years. **The ENA Open Networks Project (ON) is best placed to drive forward progress in the short term.** Any transfer of responsibilities to a new market facilitator must pick up where ON left off - a lengthy transition or restart will meaningfully set back transition objectives.

The **pace of progress of the ON has not been fast enough.** In order to ensure full delivery of ON objectives, there are a number of ways the project could be improved and sped up before the role of market facilitator is transferred. Our suggestions include:

- Ofgem to set stretching targets and work plans under the project - with complete delivery of project objectives by 2024
- The ENA must define standardisation between DNOs as the core objective of the project - where any deviations must be justified and if not satisfactory, adopted
- Ofgem must use its regulatory powers (licensing conditions and the DSO Incentive) to hold DNOs to account - penalising networks for any non-compliance, and measuring performance by outputs rather than outcomes

- Ofgem to review governance and funding arrangements for ON, giving industry greater representation on the ON Steering Group and allocating more resource to guarantee project delivery

Whilst we agree with the problem statement regarding the increasing complexity in terms of making planning decisions which balance trade-offs between different energy vectors, we **do not think the case is yet compelling enough to introduce a Regional System Planner (RSP)**. The core cause of the lack of coordination between gas, electricity and other emerging markets is the complete lack of a national net zero delivery plan. Without Central Government giving clearer guidance about the optimal decarbonisation pathways for areas with certain characteristics, the introduction of an RSP stands no chance of improving current coordination problems. In fact, the introduction of an additional party in this very crowded market could in fact worsen, rather than alleviate, coordination issues.

Finally, we agree with Ofgem that creating legally separate and independent distribution system operators is not justified relative to the cost and disruption it would entail. Therefore, we agree that DNOs remain best placed to retain responsibility for the real time operation and management of their networks, although **we urge Ofgem to effectively make use of its powers to ensure DNOs truly take a 'flexibility first' approach before considering reinforcing their networks.**

For further questions on our response, please contact
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Questions

Q1. Do you agree with our proposal to introduce Regional System Planners as described, who would be accountable for regional energy system planning activities? If not, why not?

We agree with the problem statement that further coordination will be needed across multiple energy vectors in the future as difficult decisions need to be made about the appropriate method to decarbonise specific sectors in different regions.

However, we are concerned about introducing this regional system planning role to a new body. In particular, a new additional body with planning responsibilities could increase rather than decrease friction. Given the number of bodies already active and operating in this space (DNOs, GDNs, Local Authorities), adding a new

body into the mix without a very clear mandate could exacerbate issues and further confuse understanding of roles and responsibilities.

We view that the root of issues with coordination comes down to the lack of national net zero delivery plans. Without these national plans, we are not convinced that a RSP will be any better able to coordinate activities than DNOs, GDNs and LAs already do at present. Ultimately, we need Central Government to set principles and issue general guidance on what decarbonisation pathways may be more suitable in certain situations and areas. For example, a decision on the feasibility of hydrogen for heating. Until these strategic decisions are taken, we are not convinced that introducing a RSP will improve the current situation.

Once a national plan and guidance have been issued by the Government, this top-down guidance can be used to create more granular bottom-up plans by DNOs, GDNs and LAs at a local level. On its own, this may be sufficient to improve coordination, or there may be an additional need for an RSP to deal with conflicts and translate these national plans to more regionally specific plans. However, without these national plans, the introduction of an RSP has no chance at improving coordination. The decision of whether or not to implement RSPs should wait until they emerge.

Q2. What are your views on the detailed design choice considerations described?

In principle, we recognise the potential benefits that an independent actor may bring to provide an impartial view of the optimal pathway when there are conflicting vector plans. However, it is worth considering whether there could be alternative and simpler ways of achieving the same results through strengthening or amending how electricity and gas network operators are regulated, rather than opting for the creation of a wholly new independent body to take on this function. For example, the DSO Incentive within the RIIO-ED2 price control currently rewards DNOs for coordinating with other DNOs and the ESO but does not span beyond the electricity sector. It is worth considering whether an additional incentive in both the electricity and gas network regulation could be introduced which incentivises companies for taking decisions in line with what has been decided to be the most optimal decarbonisation pathway at a regional level.

Q3. Do you have views on the appropriate regional boundaries for the RSPs?

We do not have a view on this question.

Q4. Do you agree that the FSO has the characteristics to deliver the RSPs role? If not, what alternative entities would be suitable?

We are not convinced that the ESO in its current form has the right characteristics to effectively take on this role. The ESO has little to no experience in planning at a local level, which requires consulting a much broader and larger range of stakeholders. However, the Future System Operator (FSO) could be more suitable, given the expectation that this body should be taking a whole system approach, which means considering the interactions across electricity, gas and other emerging markets.

We are concerned, however, that the role of RSP will be very time intensive and an all-encompassing role to take on. Given the capabilities of the FSO have not yet been demonstrated, it is difficult to assess how suitable this organisation may be to take on the role. Therefore, if prioritisation of FSO responsibilities is necessary in order to define and narrow its scope, we have a strong preference for assigning the FSO the market facilitator role over the regional system planner.

Q5. Do you agree with our proposal for a single, neutral expert entity to take on a central market facilitation role? If not, why not?

We agree that in the long term a single, neutral entity would be best placed to take on this role. Whilst we support the progress that has been made to date by the ON project, the pace of change has not been fast enough and the ENA's lack of enforcement powers has stunted progress. DNOs have tended to move at the pace of the slowest, given the programme is largely self-governed and self-managed by network companies - as there has been no strong incentive to be more ambitious and pave the way for change.

That being said, the worst-case scenario would be a complete pause in progress until this single, neutral expert is assigned the role (which may take a number of years if the FSO is decided to be the most appropriate party). Therefore, we urge Ofgem to think carefully about the transition to identifying and assigning this role to a new single, neutral party. In the meantime Ofgem must make greater use of its powers to encourage and award DNOs for cooperating, using the powers it has been assigned under the DSO Incentive as part of RIIO-ED2.

Q6. Do you agree with the allocation of roles and responsibilities set out in Table 2? If not, why not?

Firstly we'd like to thank Ofgem for this helpful addition. Broadly, we agree that the right primary actors have been assigned to each activity, however we note that in reality a number of parties, including market participants, should be able to influence the development of certain activities like product development, for example.

It would be helpful to expand the table to include the full suite of responsibilities end-to-end for procurement through to dispatch of services. As a future development, it would be particularly helpful if the archetypes in the Future of Distributed Flexibility Call for Input could be overlaid onto this table - so that there is more clarity on which party would be responsible for carrying out each role. One role that we'd be particularly interested in better understanding is who Ofgem envisages sending final dispatch decisions under each of the archetypes proposed - would this remain with the DNOs, or under the central market platform would this transfer to the ESO, or some other central body?

Q7. Are there other activities that are not listed in Table 2 that should be allocated to the market facilitator or other actors?

Whilst this may fall under the category of 'product development', it is worth highlighting that we see this role as going further than focussing purely on developing additional explicit products to procure flexibility. In the long term, we view that implicit approaches to value flexibility - such as the use of congestion pricing - might be more suitable to manage the increasingly unpredictable nature of constraints. Therefore, the role of the market facilitator (working closely with DNOs) should also be to assess whether the current tools being used to manage constraints continue to be effective. If there are doubts about the effectiveness of these tools, then the market facilitator should drive discussions and developments of alternative approaches to manage constraints, working closely with DNOs, Ofgem and market participants to develop these.

Q8. What are your views on our options for allocating the market facilitator role?

We agree that the FSO is likely the party with the closest synergies given the ESO's current role, which may make it the most suitable party to take on the market facilitator role in the long term. That being said, we are concerned by the amount of scope creep for the FSO - an organisation which does not yet exist - and given the current uncertainty about the responsibilities and governance arrangements of this new body it is difficult to yet make a definitive judgement about whether the FSO could be suitable or not.

In light of this uncertainty, we recommend that Ofgem considers other bodies that exist already which could be held accountable by Ofgem. One body that warrants further consideration is Elexon. As a licensed body, governance arrangements are already established, and as far as we're aware the scope of the body is not proposed to change significantly over the coming years. As such, there may be more appetite and ability to better resource this new function at Elexon, as opposed to assigning this to the FSO.

Q9. Are there other options for allocating the market facilitator role you think we should consider? If so, what advantages do they offer relative the options presented?

See our views on the long-term owner of this role in our answer to Question 8.

In terms of the short-term owner, given the pace of change needed, we believe most progress will be made by continuing with the ENA ON project. However, we urge Ofgem to review the current structure and governance arrangements of the project and to take on a greater enforcement role, through use of the powers introduced under the RIIO-ED2 price control. We also recommend that Ofgem reviews the current governance arrangements of the project and considers whether greater industry representation could be introduced on the Steering Group in order to better align project objectives with the experience and needs of market participants. Additionally, Ofgem should review funding arrangements for the project to allocate more resource to the products in order to drive faster progress and delivery.

Q10. Do you agree that DNOs should retain responsibility for real time operations? If not, why not?

Yes. DNOs have by far the best understanding and knowledge about the operation and functions of their networks. We also support Ofgem's decision that the benefits of creating legally separate distribution system operators do not outweigh the costs and disruption.

We will not respond to Questions 11-15.