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Ref : Future of Local Energy Institutions and Governance

Thank you for the opportunity to respond to the "Future of Local Energy Institutions and Governance" consultation. Please find below E.ON's response.

Summary

E.ON is pleased to see Ofgem re-visiting the questions originally raised in 2022 under the "Call for Input on the Future of Local Energy Institutions and Governance", as well as acknowledging the protracted nature of progress to date in achieving a consolidated position across industry and consumers.

As per our response in April 2022¹, it is discouraging that it has taken nearly four years since Ofgem's positional stance on DSOs to get to this stage, as well as the fact a second Call for Input (Cfi) is now required. This is especially pertinent given the large amount of work that was put into this topic by industry through the Open Networks Project Future Worlds impact assessment back in 2019. However, we are cognisant that the energy crisis has required some pieces of evaluation to be put on hold and we support the drive to progress this now. It also clearly makes sense to align this Cfi with the parallel Consultation around the Future of Distributed Flexibility.

We agree that Ofgem is considering the right key energy system functions (planning, market facilitation and operation). As per our Apr 22 response, we believe communication (in terms of ensuring that any institution has a requirement to keep stakeholders informed and looks to engage on a regular and bi-directional basis) and consistency (in terms of ensuring that all institutions are run on a similar basis across the country to ensure that all customers benefit equally and can participate) continue to be key deliverables.

¹ We are disappointed that it has taken nearly three years since Ofgem's positional position on DSO to get to this next call for input, especially given the large amount of work that was put into this question by industry through the Open Networks Project Future Worlds impact assessment back in 2019

E.ON is supportive of the principle Ofgem outlines that a single body would be able to deliver large synergistic benefits, but would like to emphasise that this ability to optimise and co-ordination must not be done at the expense of the credibility we see as a key component in order to a) deliver a fair and impartial flexibility market and b) ensure the Consumer-owned Energy Resource (CER) engagement required in order to meet the 2035 decarbonisation target is delivered. We believe there is an encouraging precedent for separation of a system operator in the splitting of the ESO from National Grid Transmission (NGT) which led to neither safety issues nor conflicts of interest. It must be noted though, that this transition has highlighted areas of concern e.g. IT systems which are relevant to both this Cfl and more specifically for the "Future of Distributed Flexibility" Cfl.

We are also in agreement that there is little DNO accountability achieved under the current status quo (since some DNOs opt to deliver a baseline, minimal DSO functionality), credibility (due to prospective conflicts of interest) or coordination (as evidenced through the lack of progress in primacy rules between DNOs and the ESO).

However, we are of the opinion that the current Distributor Licence Conditions² already allow for several of the issues raised within this Cfl to be addressed and that this is under-utilised as a piece of legislation.

We believe that the regulatory powers conveyed upon Ofgem under Condition 2, for example, as well as several stipulations within the Licence Conditions, mean there is more that can be done in the immediate term. The Licence Conditions set out clear requirements under "Condition 31E: Procurement and use of Distribution Flexibility Services" around flexibility, stipulating that DNOs have a responsibility to procure fair, transparent, and standardised distribution flexibility services and that this must be carried out in a co-ordinated manner with the ESO. This condition lays the foundations upon which marked progress could be delivered now against the ambitions outlined within this Cfl, particularly around achieving a more cohesive and transparent approach to flexibility.

Whilst the Licence Conditions are unambiguous in relation to DER flexibility market requirements, they are less explicit around CER. E.ON fully endorses Ofgem's goal of widening flexibility access for CER and see this as a critical element of this Cfl. Nonetheless, there is scope to incorporate CER more explicitly within the Distributor Licence Conditions as they stand. For example, there is the requirement to treat all users of the network, including domestic customers fairly, (10AA.4 "Standards of Conduct")³ and 10AA.8 which defines a "Customer Objective" as meaning "the Fair treatment of each Domestic Customer, including Domestic Customers in a Vulnerable Situation".

² [Electricity Distribution Consolidated Standard Licence Conditions \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/electricity-distribution-consolidated-standard-licence-conditions)

³ 10AA.4 "Standards of Conduct" which states that "the licensee and any Representative must: (a) behave and act in a Fair, honest, transparent, appropriate and professional manner"

The Distributor Licence Conditions also contain provisions relating to the requirement for DNOs to work with all other parties (Suppliers, TSO, DNOs and LDSOs) to meet whole system obligations (Clause 7A).

It is evident from the above that much of the legislative infrastructure is already in place to deliver the objectives this Cfl is exploring (as a minimum in relation to DER) with immediate effect and that this can be built upon for widening access to CER. Therefore, whilst we agree with the flexibility market deficiencies which Ofgem outlines within this document and, have taken the approach when answering the questions below of considering each proposal as a stand-alone measure on its own merit, we would urge both the DNOs and Ofgem to use the agency the Distributor Licence Conditions confers upon them more fully whilst the implementation of the proposed changes is considered. It should also be noted that, if the propositions in this Cfl – that the Regional System Planner and Market Facilitator Role are to be carried out by the FSO – are implemented, this may require a clear legislative re-assignment of responsibilities (from Ofgem to the FSO, or another chosen body).

Finally, we believe it is important that the ambitions outlined in both this Cfl as well as the “Future of Distributed Flexibility” Cfl complement in flight reform under RIIO ED2 business plans.

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 are supportive of the principle of what Ofgem are trying to achieve through the instigation of a national Regional System Planner and appreciate the rationale that, as a single entity, it should be able to ensure consistency/accountability. We also follow the logic behind the proposed structure, with multiple regional branches, and can appreciate that this should support the integration of planning across vectors/regions/voltage levels (which will becoming increasingly important in order to deliver whole system optimisation).

We also strongly agree that the status quo concerning a harmonised and consistent approach between local and national planning (as well as markets) is overly complex and would benefit from a simplified approach and we also concur that any co-ordination needs to be delivered via an expert body. This should help stakeholders such as Local Authorities (LAs) to navigate flexibility markets as well as to ensure there are no inadvertent oversights which could have operational/safety/other implications.

We believe that planning on a distribution network level inherently requires greater coordination with stakeholders than at national level since small loads/generators have a more disproportionate impact on the various networks. Please see our response to the April 22 Consultation for more detail behind this which is attached alongside this response.

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

As per our April 22 response, we would like to reemphasise that the entities which rely on local energy institutions and governance are not limited to LAs and network/system operators. Energy suppliers also play a key role in acting as a conduit between network/system operators, local authorities and DER or CER (including via community energy schemes) and should not be overlooked in this discussion. E.ON's City Energy Transformation team, for example, already fulfils an important role co-ordinating local government to inform energy plans and helps develop local government competency in this area. E.ON Group have delivered demonstrable pockets of local energy excellence in European cities such as Malmö, Berlin and Milan. As per the above, E.ON's City Energy Transformation team works closely with LAs to provide energy solutions on a pan-urban level. The team have access to digital energy optimisation software to co-ordinate cross-vector energy solutions, as well as grid oversight, both of which allow them to take on this co-ordination role. Whilst we are not advocating an energy supplier should take on the role of Regional System Planner per se, we believe E.ON's existing work in this arena is a useful example of good practice which can be built upon.

With Ofgem's proposal around Regional System Planners (RSPs) as it stands, the obvious challenge will be around ease of implementation, as well as ensuring sufficient time is allowed to create a new body which is fit for purpose (notwithstanding our comments in the Summary section). We recognise this may require re-assigning existing functions, to a degree, but – due to the proposed remit of RSPs – this will necessarily also involve the requirement to remove functions from bodies not directly under Ofgem's control as well which would not be straightforward.

Depending on the final choice of body elected to act as RSP, Ofgem may need to instigate the change via primary legislation which could be a protracted process. If the development of the measures outlined within this CfI is heavily contingent on a RSP being in place, this could then jeopardise the rapid expansion of flexibility the electricity system requires in order to decarbonise by 2035. As such, we believe the remit of the existing Distributor Licence Conditions should be explored more fully in the immediate term (regardless of the outcome of this CfI).

Nonetheless, we are supportive of the delivery objective of a RSP and believe it is credible that, if designed and implemented appropriately, a RSP could offer value particularly for CER. It is evident that, aside from a few pockets of excellence, a knowledge gap as to how networks function (from an engineering perspective and their governance) permeates local governments, councils, housing associations and energy communities and we agree that this is rightly not their area of expertise. We therefore believe that a key area in which an RSP can add value would be in the provision of easily digestible information, education and knowledge, tailored appropriately according to region/recipient of information.

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

We agree that coherency and oversight is likely to be best achieved through having a single body which has an over-arching responsibility for optimal system planning/expertise. We also believe that it would be inefficient to have too great a number of regional branches. We therefore support the high-level structure proposed by Ofgem but believe it is worth highlighting that, even within a single local government authority, (and particularly when considering large municipalities), there can be several competing/opposing political agendas and so this is a landscape which will need to be carefully managed.

In terms of the high-level regional boundaries, we would advocate maintaining existing DNO boundaries where possible on the basis that these are already well-established and should also facilitate efficient dialogues since each regional branch of the RSP will only be directly dealing with one network operator.

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

Notwithstanding our commentary in the Summary section, we believe that the FSO has many of the characteristics required to deliver the RSP's role, as evidenced by the bringing together of the planning functions of the national ESO and GSO. Assigning the responsibilities of the RSP to the FSO could allow several of the opportunities and benefits associated with consolidation, such as the ability to avoid the duplication of systems and roles, to be exploited to the full. It could also naturally encourage optimisation across both geographies and voltage levels.

Whilst the FSO is in some ways a natural fit (as outlined in the above paragraph), it is essential that – if they are the designated RSP – there is demonstrable impartiality in terms of market participant engagement and sign-posting to ensure all parties are treated equally and that there is a level playing field across all regions. This would need to be achieved via robust governance and accountability, the foundations of which are already incorporated into the existing Distributor Licence Conditions as mentioned earlier.

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?

Building on our earlier comments, we support the objectives Ofgem outlines for a single, neutral expert entity to take on a central market facilitation role, particularly in relation to CER, and agree with the two priorities outlined to be addressed in the first instance: (a) reducing friction across distribution markets, by simplifying processes, reducing barriers to entry and ensuring consistency (b) aligning distribution and transmission market arrangements.

We also welcome the principle of developing more specific goals around standardising products (as outlined under section 4.7 of the Consultation) and feel it is imperative that, if a Market Facilitator is introduced, its remit is both completely transparent as well as very clearly defined. This includes ensuring that any overlap with existing Regulations such as the Distributor Licence Conditions is taken into

account. Without this, there is a risk a Market Facilitator could introduce greater complexity, confusion around existing roles and responsibilities, as well as reduce the limited (in practice) accountability which exists under the status quo.

We fully support the concept that the role of the Market Facilitator could evolve over time, although the conditions under which a change in responsibilities/remits may take place are vague in this Call for Input and, as stated above, may also require a change to existing Regulations.

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

Considering Table 2 as a stand-alone proposal (in isolation from pre-existing regulatory roles and responsibilities as referred to in the Summary section), the proposed allocation of activities by each respective body/participant is a useful starting point which aids a clear understanding of the envisaged division of undertakings between all parties. The principles behind the assignment of responsibilities are pragmatic/logical, however it must be acknowledged that there will inevitably be overlap. This seems particularly relevant when considering activities such as “engaging with market participants” and “market oversight” which we believe would benefit from expansion in terms of their scope to ensure critical activity does not fall between the gaps. Examples of potential overlap include the extent of “engagement” with market participants since registration, pre-qualification, etc are set out as sitting under “Market Enabling and Infrastructure Platforms” whereas since these are platforms, it doesn’t seem unreasonable to assume they are passive to a degree and therefore reliant on some active involvement. Similarly, “market oversight” could be interpreted in many different ways and the boundaries of this activity would, again, merit further clarity. This is acknowledged within the Consultation.

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

As the Cfl alludes to, the list of activities is not exhaustive and will evolve as flexibility markets develop and change over time themselves. For this reason, and considering the Market Facilitator proposal as a stand-alone measure, we believe its activities should be reviewed at regular intervals to ensure they are still fit for purpose, whilst balancing the need for some continuity of landscape for all involved.

As per our commentary under Question 6, whilst we are supportive of clearly assigned responsibilities to ensure best practice and accountability in any arena, we would urge Ofgem to expand upon exactly what these will involve. Without this level of detail, the introduction of a Market Facilitator could simply add in another level of bureaucracy/complexity which would undermine the very purpose of its existence.

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

Again, considering the Market Facilitator role in isolation from existing regulatory roles and responsibilities, we are supportive of the deliverables Ofgem has outlined to be delivered through this route. We agree that it is imperative that any entity which takes on a facilitatory role should act independently and be accountable for decision making. To achieve delivery at pace, they should also possess sufficient credibility and flexibility market design expertise, allowing them to align distribution and transmission market arrangements. Finally, we believe it is imperative that any Market Facilitator should have the capability to represent all stakeholders in an open manner, in order to encourage widespread flexibility participation across all energy vectors around the UK.

We appreciate the position put forward in this CfI that the FSO should be able to be held accountable if it took up the role of Market Facilitator (in no small part owing to its current regulated set up), and concur that it has the relevant expertise to a large degree. It would be in a unique position to be able to align distribution and transmission markets, a role it is starting to engage in as it expands its DER markets such as Distributed Restart, and Voltage Pathways. Nonetheless, current delivery against these emerging DER markets is slow which is a concern for E.ON. We also have reservations around impartiality if, as Market Facilitator, the FSO were to continue in its current remit as a flexibility buyer within the market and so believe regulations to ensure it acts in a fair and impartial manner if it adopts the role of market facilitator would be required.

Whilst complete impartiality could theoretically be achieved through setting up a newly created neutral third party body, the inefficiencies and administrative costs associated with this are likely to outweigh the benefits and, as stated in the previous paragraph, impartiality should be able to be achieved through appropriate regulatory mechanisms. We therefore believe this option has limited merit.

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?

As per our comments in the Summary, the Distributor Licence Conditions already lay the foundations for the activities outlined under the proposed Market Facilitator role – for example in relation to standardisation and working with a whole GB System approach. As such, we believe these should be more fully exploited in the immediate term.

However, if considering the allocation of the activities as a separate, stand-alone measures, we do not believe setting up a further independent body is necessary to address concerns around impartiality and we see no other credible alternative options for the reasons set out in the Call for Input.

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

As per our response to the Apr 22 consultation, we believe that real-time network monitoring across all voltage levels will be fundamental to deliver both the

transparent data and visibility/knowledge of the network that the other two functions (planning and market facilitation) will depend upon in order select the most effective, low carbon and low-cost flexibility solution.

We agree that DNOs should retain responsibility for real time operations. However, our preference is for there to be legally distinct Distribution System Operators (from DNOs) and we believe a credible precedent has been set in this regard via the establishment of the ESO. If legal separation is not achievable, then we would strongly argue for the current status quo to be addressed, in the first instance, through the existing provisions within the Licence Conditions and through the instigation of the measures outlined in ED2 whilst the proposals within this Cfl are developed further.

We would also urge consideration, to allow for a prospective legal or - at least - functional split of DSO operations and activities in the future, of ensuring DSO systems and processes be kept separate wherever possible from those of the DNO.

To expand upon our reservations with the current status quo, we do not believe that there is a sufficient culture of accountability at present, with DNOs often delivering a baseline, minimal DSO functionality without penalty. Credibility is also questionable, owing to the inherent conflict of interest for DSOs around facilitating multiple, cross-regional markets. Finally, there is a lack of coordination between bodies, as evidenced through the lack of progress in primacy rules between DNOs and the ESO.

We also agree with Ofgem that DNOs have not demonstrated the necessary experience (or competency) that would be required to run competitive flexibility markets and that there would be a requirement for all DNOs to build up this expertise separately. This could be extremely resource intensive, as well as leading to high levels of duplication across all six companies (for example in relation to IT systems, FTE experienced in market design and development, market operation, etc).

It should also be noted that there is a very real risk that DNOs, if left to continue to operate "as is", would develop their flexibility markets at different rates and with varying levels of competency which could lead to a postcode lottery in terms of developing local markets.

Ofgem's stated objectives around the roles of Market Facilitator and an RSP both go some way to addressing the above challenges, if instigated in a manner which complements their existing regulatory powers and in-flight change. We agree that the ambitions within the Cfl around transparent operational decisions, significant improvements in operational coordination, and the modernisation of DNOs' internal data processes and capabilities should support compliance with new data standards (by whichever implementation route is chosen).

Q11 What is your view on our proposed approach to the undertaking of an impact assessment as outlined in Appendix 1?

We support the proposed approach to the undertaking of an impact assessment - namely to seek to identify the costs and benefits that could be directly and indirectly attributed to Ofgem's proposals for the RSP and market facilitator roles, as well as any interactions with real time operations. It is also useful to have the nature of the counterfactual clearly set out – i.e. the implementation of existing policies, including those required within RIIOED2 (including the minimum requirements for DSO functions in the RIIO-ED2 Business Plan Guidance as well as the scope of regional/local planning and coordination activities across energy vectors within the Smart Optimisation Output licence obligation). As set out within our answers to this Cfl, we do feel the existing agency attributable to all parties within the Distributor Licence Conditions is overlooked and would urge this to be considered more closely within both the counterfactual scenario and as a short term means of delivering improvements.

As Ofgem acknowledge, whilst this Cfl sets out a laudable ambition, with a clear delivery route, it would also be hard to isolate the impact of the proposed measures explicitly in view of the scale and pace of energy market change in general. Ofgem is right to reassert what it sees as the specific goals relating to effective governance criteria including the delivery of coordinated whole systems planning (facilitating long-term investment decisions, accessible flexibility markets and reliable, transparent operations), although we believe this is catered for under existing regulations to a large degree anyway.

Q12 What is your view on the most appropriate measure of benefits against the counterfactual from the package of measures designed to enhanced flexibility, of which our governance proposals are a key enabler?

Notwithstanding the above, we agree with the suggested additional benefits with respect to the counterfactual: flexibility, data quality improvements, improved market participation of flexible resources as well as the anticipated deferred reinforcement of networks and decarbonisation synergies. Out of those cited, we are also of the opinion that the measures could support delivery of the "softer" benefits of more transparency of decision making and increased stakeholder confidence which should be given equal weight.

As a whole, as Ofgem state, the proposed measures, when considered in isolation, should deliver holistic system benefits. These are difficult to quantify and, indeed, attribute directly to the proposals but we believe there could be a discernible impact which could be related specifically back to these measures. We would also expect to see better equality of access to the flexibility market and benefits across all users of the network, and particularly CER, as outlined.

Q13 How should we attribute these benefits between the governance changes in the proposed option, and other changes required to achieve the benefits? We particularly welcome analysis from bodies that have undertaken an assessment of

benefits - specifically how those benefits might be attributed to different policy reforms that are required to achieve those benefits.

We do not have any additional comments to those in the Call for Input and those in our responses to the other questions.

Q14 What additional costs might arise from our governance proposals? We welcome views both on the activities that may arise and cause additional costs to be incurred, as well as the best way to estimate the size of the costs associated with those activities.

As Ofgem rightly assert and, as per our response to Question 15, it is credible that the net impact of the reform could be zero cost or a delivery of cost savings over the lifespan of the measures. However, we are not in a position to comment in a more meaningful way. We agree that there will be transitional costs but do not have any additional comments to those outlined in the Call For Input.

Q15 What additional costs may arise from sharing functions with a number of interacting organisations? We welcome views on set up cost, lost synergies, and implementation barriers.

We do not have access to data which would allow us to quantify additional costs but assume there will be a net cost saving across the lifetime of the measures which will be delivered through centralisation and wider/full market oversight. It should be borne in mind that any costs of delivery will increase the longer the creation of the various bodies takes to implement.