



Optimal Power Networks

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Dear Fiona

Consultation on the Future of Local Energy Institutions and Governance

Thank you for the opportunity to respond to Ofgem's consultation on the future of local energy institutions and governance, issued on 1 March 2023¹. This letter is submitted on behalf of SSE's IDNO (Optimal Power Networks). We have provided answers to the specific questions posed in the consultation in an annex to this letter, but also felt it would be helpful to make the following high-level observations.

IDNO

We all share an ambition to achieve net zero and do it in a cost-effective way. Government and Ofgem are prioritising moves to enable net zero at the lowest cost to consumers, and are encouraging new providers to enter the market, introducing new technical, commercial and funding solutions. Ofgem believes current arrangements are not geared up to support these ambitions. Ofgem is looking at Local Energy System models as a solution and this could vary from region to region, neighbourhood to neighbourhood, with competition to ensure flexibility, resilience and decarbonisation at lowest cost.

From an IDNO perspective, our main comments are:

- Where competition in onshore electricity distribution is considered in the consultation, there is little recognition of the existence of IDNOs, and no differentiation between ICPs (who build the networks) and IDNOs who own and operate them

¹ [Consultation: Future of local energy institutions and governance | Ofgem](#)

- IDNOs have demonstrated innovation and have brought business models that have delivered cost reductions in new energy infrastructure provision. IDNOs have invested many millions of pounds in this infrastructure, and have many millions more to invest in the coming years
- Competition in electricity distribution is increasingly moving away from the traditional asset build solutions (which aligns with existing ICP and IDNO business models)
- Aligning IDNOs to the legacy regional monopoly provider DNOs is less well suited to the more dynamic, competitive, multi-vector energy system of today
- IDNO business models are diverging from the DNO model, and indeed from IDNO to IDNO, as new providers with different backgrounds and skillsets enter the market. We believe that there is scope for more innovative provision that can benefit customers both in terms of cost and carbon reduction
- It is imperative that key energy system functions are performed by institutions with the competence, appropriate skillset and incentives to drive net zero at least cost - IDNOs have demonstrated these capabilities
- Ofgem's Call for Input recognised that "The difference between local needs and opportunities across Great Britain means that investments suitable in one area will be less appropriate in another." IDNOs have GB-wide expertise, and relationships, and can share learning across regions and stakeholders

This is not an argument in favour of the status quo. We agree there is a case for implementation of new models to ensure the urgent changes to our system that are required to enable net zero can be made quickly. True whole-energy-system thinking is hamstrung for IDNOs by the licence requirements on independence that are designed for the large, geographic monopoly DNOs.

The current licence and code obligations and charging structures for electricity distribution inhibit innovation and disincentivise multi-vector partnerships, by forcing IDNOs into a rigid, licence-defined silo. Making changes to the IDNO licensing regime would avoid penalising IDNOs relative to providers of alternative energy network solutions and encourage the development of novel technical and commercial models to support the transition to a net zero electricity system. Granting greater flexibility to IDNOs would be a quick win with limited risk to wider system operation.

About OPN

OPN received its IDNO license in April 2020 and now has a growing order book of projects including business parks, EV charging sites, electric bus depots and mixed residential/commercial developments. OPN is committed to contribute significantly to the low-carbon transition in the UK, through enabling electrification of heat and transport, and providing infrastructure to support renewable generation.

A Whole System approach accelerates customers' transition to net zero and creates a more resilient and sustainable energy system by investing in, building and connecting localised flexible infrastructure, using technology and data analytics to drive the long-term performance of energy assets.

OPN's View

Further details on how Ofgem's proposals would work in practice should be shared with industry before any decisions are made. Ofgem should consider what these proposed new roles might look like in practice, what deliverables would be expected and how it would hold parties to account. Whilst we welcome Ofgem's commitment to carrying out an impact assessment on its proposals it is hard to fully comment on the proposals without seeing this.

It is important that industry is given an opportunity to comment further once Ofgem has identified the impacts ahead of any final decision. We look forward to more detailed discussions with Ofgem as Ofgem develops its thinking and proposals.

Yours sincerely,

Sally Musaka
Enterprise Regulation Manager

Annex 1

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?

As part of this Ofgem has consultation, Ofgem have suggested using RSP. Introducing RSPs would streamline the current approach to regional energy system planning by introducing accountability for the activity and solidifying the process for how those with a democratic mandate interact and influence the more technocratic aspects of planning and vice versa. It would also drive greater transparency regarding system requirements and what the market can provide which would illuminate any bias in network companies' decision making (ie highlight conflicts of interest)

Ofgem intends to follow up with a decision and impact assessment later in 2023. From our view,

- Without an Impact Assessment it is difficult to judge as well as fully understand the risks, costs and benefits will be.
- We would also suggest that the Impact Assessment considers IDNOs.

In terms of Value to customers, the structural changes required to satisfy many of these models set out by Ofgem in this consultation will represent significant cost. **As such, any major structural industry change might cause disruption, delay and significant cost, and should be assessed using a robust CBA and Impact Assessment.** This is to ensure that any model taken forward is aligned to Ofgem's statutory provision under Section 3A of the Electricity Act 1989(the 1989 Act), to *“protect the interests of existing and future consumers in relation to electricity conveyed by distribution or transmission systems.”*

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

In the current arrangements, accountability is the issue therefore having an independent body is the starting point for defining roles and responsibilities.

We agree that this independent body should be regulated given its monopoly position. Providers into this new body could be less rigidly regulated in order to facilitate innovation. Licensing and monitoring by RSP could ensure safety and customer-service compliance, if this does not create a new class of network provider that excludes IDNOs.

At the local level, RSPs should be the focal point within a group of interacting organisations and should include network companies, and local/regional government.

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

Given the interconnected nature of the GB energy system, and the differences in local government boundaries, there are several different models that could work. In consideration of the need to encourage multiple stakeholders across several energy vectors, we would feel uncomfortable if the regional boundaries are aligned too closely with the current DNO boundaries, as this could create perceptions of alignment between the organisations.

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

Given that the FSO/ISOP does not exist at this time and therefore whether it has the characteristics to deliver the RSP role will depend to some extent on how roles, responsibilities and resources are transferred from NGESO. However, we are not convinced that the ISOP will have the characteristics to deliver this role.

Although NGESO has a role in transmission planning it has limited expertise in distribution and is unlikely to have the knowledge of local networks necessary to undertake this role. It is also important to consider the resources the ISOP is likely to have and how any new roles might impact its core system operator activities. Specifically:

- The ISOP is being considered for a variety of new roles and we are concerned about whether it would be able to take on all of these quickly and efficiently. There is a risk that it becomes too big too quickly.
- The transfer (of roles and people) from NGESO to the ISOP is not without its risks. It would be prudent to wait until that transfer has been successfully managed before asking the ISOP to take on new roles.

This could mean a delay in progress. The ISOP is being created, in part, to remove existing conflicts of interest within National Grid (which are currently managed by complex business separation arrangements). In considering new roles for the ISOP Ofgem needs to be mindful not to create new conflicts of interest or potential for bias (real or perceived).

We agree that planning responsibilities should sit with those parties who are competent and have the right expertise to deliver them. We believe this should be the existing parties, and not another regulated body, given the existing wealth of knowledge and expertise that these bodies have

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?

It seems sensible both for consistency and coherence. We also agree that a single, expert entity is necessary to ensure that accountability for developing and monitoring the implementation of key outputs sits with one party.

Having a single entity would avoid duplication of roles and reduce risks of conflict or confusion. Any existing entity might be missing some capability or have some knowledge gaps to be able to take on this responsibility immediately. Therefore, it is important to understand how the transition to these roles would work to ensure there are no disruptions?

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

The table does not include IDNOs, and it is unclear whether they are expected to have a bespoke role in the facilitation of flexible resources, as distinct from DNOs.

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

No comment

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

None of the parties considered are ideally placed to take on the role envisaged. We have outlined our concerns about the ISOP taking on additional roles in our response to question 4. An alternative could be a data company or Elexon.

Given that FSO has capability and expertise in transmission system but not distribution, it may be well positioned to align distribution and transmission markets. However, as a flexibility buyer within the market itself, we are concerned that impartiality could be an issue. As such, development of competitive models is key. It remains to be seen whether competition will be more aligned to a current Distribution model, or the proposed Transmission models?

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?

Several credible options have been presented, all of which have advantages and disadvantages. Given the risks of conflict of interest, it might be worth considering whether a neutral body such as the Energy Systems Catapult would be appropriate for delivering what is needed without conflict of interests.

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

Yes, in our view the current approach generally works well, and we see no compelling case for change.

However, currently, there is no clear distinction between a DNO and an IDNO, as the assumption is that they are both the same, which is not the case. We suggest that a clear role distinction is considered between DNOs and IDNOs. Further thought should be given to make clear where there is a distinct role for the IDNOs and what the market for it is.

We agree with this point as it will ensure operational coordination is effectively delivered in retaining real time operations, including procurement and dispatch, DNOs will be required to work closely with the FSO to ensure actions taken on the distribution and transmission network are coordinated. However, we need to understand what the impact will be on IDNOs. Especially, as in our response to Q3, if links are established between RSP/FSO and DNO, does that leave a market for IDNOs to participate in?

Other points to consider in order to allow IDNOs grow are:

- More freedom for IDNOs could enhance whole-system, multi-vector approaches and the development of integrated smart network solutions

- IDNOs have the capabilities and credibility to deliver, own and operate power network infrastructure nationwide, and are at the forefront of newbuild electricity infrastructure
- The IDNO market can function well to drive innovation in service & cost, but IDNO relationships, stakeholders and business models are different to those of DNOs

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

An impact assessment or CBA is an essential part of the decision-making process and in our view, this should be carried out and shared with industry ahead of (rather than alongside) any decision. It is important that industry participants can comment the detail of the likely benefits and costs of Ofgem's proposals. This should also consider the impacts; risks and it will have on IDNOs.

It is important that any changes made are clearly shown to provide a net benefit and that issues around implementation are appropriately considered. If the impact assessment does not show clear net benefits, then Ofgem must reconsider its proposals.

Q12. What is your view on the most appropriate measure of benefits against the counterfactual?

Under the counterfactual Ofgem would use the scope of regional/local planning and coordination activities across energy vectors within the Smart Optimisation Output licence obligation in RIIO-ED2 and so we question how this would work for IDNOs. IDNOs are assumed to be funded through the same mechanisms as DNOs, and therefore need large, diverse, scaled portfolios to achieve the same returns. This funding model means IDNOs have to be similar to DNOs in order to be financially viable.

It is important that Ofgem includes the realisation of benefits associated with current workstreams (Open Networks etc) in the counterfactual and only allocates benefits to the proposal where these cannot be delivered under the current arrangements. Given most of the proposals relate in some way to the new (not yet formed) ISOP there will be several challenges in creating a counterfactual. It is important that the impact (or risk) to delivery of core system operator responsibilities.

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 benefit.

No comment

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.

The detail of the proposals will significantly impact the likely costs. Therefore, it is important that Ofgem appropriately takes into account the detailed design choices it faces. For example, the costs associated with RSP's will vary considerably depending on how regional boundaries are drawn. It is also important that Ofgem consider the proposals in light of other changes happening in the industry (including the creation of the new ISOP). Moving (or duplicating) roles between bodies can have a significant impact on industry resources. There is a limited pool of qualified professionals able to carry out these roles and the significant impact of the proposals on resourcing should not be underestimated.

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

No comment