

Ofgem: Future of local energy institutions and governance

10th May 2023

Context

Sembcorp Energy UK (SEUK), a wholly-owned subsidiary of Sembcorp Industries, is a leading provider of sustainable solutions supporting the UK's transition to Net Zero. With an energy generation and battery storage portfolio of over 1.3GW in operation or under development, our expertise helps major energy users and suppliers improve their efficiency, profitability, and sustainability, while supporting the growth of renewables and strengthening the UK's electricity system.

Our Wilton International site, within the Teesside Freeport, sits amongst a hub of decarbonisation innovation. At the site, we provide energy-intensive industrial businesses with combined heat and power (CHP) via our private wire network that supplies electricity generated by gas and biomass.

These services are complemented by our fleet of fast-acting, decentralised power stations and battery energy storage sites situated throughout England and Wales. Monitored and controlled from our central operations facility in Solihull, these flexible assets deliver electricity to the national grid, helping to balance the UK energy system and ensure reliable power for homes and businesses.

Company registration no: 11369893. For more information on Sembcorp Energy UK, visit www.sembcorpenergy.co.uk

SEUK Response

SEUK are pleased to respond to the Ofgem Consultation on Local Energy Institutions and Governance dated 1st March 2023. To clarify our response is not confidential.

3. Proposed governance reform: energy system planning

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?

Whilst we see the potential benefits of introducing Regional System Planners (RSPs) the resolution of conflicts that may emerge from the proposed new structure will need to be considered. This is especially true if the new role of FSO is to be accountable/ responsible for both the new RSPs and ISOP roles. We agree with and support the notion that the introduction of new RSPs will begin to address issues around accountability, it must also be made clear as to the roles and responsibilities of the proposed new roles and the knowledge and skill sets required to achieve these.

There will be a need for the RSP to balance system requirements and limitations with non-energy drivers of consumer welfare, such as those that drive social development. The co-operation between RSPs, DNOs/GDNS, Local Authorities and commercial parties must be transparent with clear paths for conflict resolution.

RSPs should ensure that the holistic energy system planning continues to meet Ofgem's chosen criteria. As real-time operation is envisaged to remain with the DNOs and GDNs there must be a clear view and understanding of how the roles and responsibilities of the new RSPs and these institutions align. For example, the development and ownership of regional energy system planning, the yet to be defined DSO roles and cross-vector planning, the coordination and coherence of planning activities, the provision of an impartial view of optimal pathways and the development of data standards, access permissions and digitalisation consistency. The benefits of the proposed reform could be easily undermined if there is a disconnect between planning requirements and the effective and efficient operation of the networks. In electricity transmission, there is the Network Optimisation Assessment and related procedures that weighs up costs and balances between network build and real-time operation in a transparent manner. There should be a similar and proportionate process for system planning between RSPs and network operator to ensure consumers get the best value.

Given the information currently provided within this consultation if the proposal is to introduce the new role of Regional System Planners who are **accountable** for regional energy system planning, then this creates the need for another role to be fulfilled who will be **responsible** for all aspects of these planning activities. This role should be independent of the RSPs themselves to avoid potential conflicts of interest or would require oversight from an independent body, similar to Ofgem's current oversight of transmission networks. Alternatively, and possibly a more effective approach would be for the RSPs to be accountable to the FSO, with suitable monitoring and performance metrics. We therefore ask that further clarification is provided as to how Ofgem see the development of these new roles to establish the clarity required at the earliest opportunity.

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

We consider the detailed design choices that have been identified to be key in establishing the RSPs and agree that it is critical an independent actor can look across multiple energy vectors. There is a clear need to ensure accountability, with the chosen institution needing to be both independent and flexible to be able to accommodate existing and future energy vectors, as they emerge and manage the planning required to achieve optimal, cost-effective outcomes.

As has been stated, there is a requirement to establish the regions at the earliest opportunity as this would ensure that the foundations for these new functions can be

established as quickly as possible. This will ensure that a consistent approach can be developed to be able to coordinate planning at both a local and national level.

We understand the reasoning behind the suggestion that the FSO could take on the role of RSP, but careful consideration is needed here to ensure that as the establishment of the new FSO will require some organisation in itself and that adding further responsibilities to a newly formed institution does not slow down the development of the intended roles and responsibilities or indeed the benefits that Ofgem envisage the RSPs can bring. It is also not clear whether the RSP would be held accountable by the FSO (i.e., within itself) or the responsibilities of the RSP would be accountable to government as another role of the FSO.

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

The development of appropriate regional boundaries is critical to achieve Ofgem's ambitions. However, this is not a trivial task given the current boundary misalignment that currently exists between DNOs and GDNs. Furthermore, there is a need to ensure that LA jurisdictions are not impacted as a result of new boundary definitions as it would be sub-optimal for LAs to have to deal with multiple GDNs and DNOs.

One potential starting point for the establishment of regional boundaries would be to attempt to align the existing DNO and GDN boundaries, where possible. This approach would then highlight any potential issues that would need to be addressed, at the earliest opportunity. This should then help to provide a clearer view regarding the definition of clear boundaries whilst maintaining minimum disruption to planning roles and responsibilities in terms of a region's infrastructures. In addition, this approach would also ensure that the DNOs and GDNs with the knowledge and understanding of their network's regional requirements are appropriately represented within each RSP region that is defined.

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

Whilst we agree that the FSO has the characteristics to deliver the RSPs role, it must be clearly understood how this newly formed institution will accommodate this additional role and responsibility and where the skilled knowledge and experience will come from. For example, it is possible that the FSO will need to establish the appropriate expertise at the Distribution level and so they may require further time to develop an equivalent level of expertise here.

Further work will be required to ensure that when the FSO is established (date still not clear) that appropriate measures are put in place to ensure that this new institution is, and remains, truly independent. We further support the need for the FSO and RSPs to be fully regulated, as monopoly organisations and answerable to Ofgem as the regulator.

4. Proposed governance reform: market facilitation of flexible resources

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 with the proposal for a single, neutral expert to take on the role of central market facilitator. The energy market will be required to change fundamentally to meet new demands and accommodate new technologies, as they emerge.

For this reason, it is vital that the markets continue to be developed flexibly and that these remain accessible, transparent, fair, and coordinated. Whilst there are several possible approaches to achieve central market facilitation, from extending the remit of existing organisations to establishing new ones, to do this efficiently and cost-effectively will be challenging and will require the successful organisation to be both independent and agile.

For example, Elexon currently has the knowledge and expertise to be able to take on this new role for electricity but may require additional support to cover gas. We note the work of the Open Networks initiative and the general view that progress has been slow due to several issues including lack of resources, having the necessary viries to progress work and most importantly the challenge of accommodating disparate views from members who are seeking developments in different directions and at different rates.

Whilst we do not currently have a suggestion as to the appropriate body for this new role, we suggest that a review of these and other approaches is undertaken to obtain a deeper understanding of the requirements and to develop a clear view as to the principles that must be met and the criteria and measures that should be applied to progress to the next stage of development.

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

Whilst we acknowledge that the roles and responsibilities set out in Table 2 are a good starting point, these activities and where they are placed, will be dependent on the core functions and skills of the successful market facilitator and how Local Energy and governance arrangements are developed.

For this reason, we suggest that these currently remain open for further discussion. For example, if the Market Oversight activity is essentially performance assurance, then it could be argued that this should be independent of the FSO to avoid any potential conflict of interest.

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

Flexibility is required at local and national levels, so there would need to be clarity around interactions with flexibility markets and initiatives, such as the Balancing Mechanism and the ESO's Demand Flexibility Service. A successful flexibility market also requires knowledge of the participants and future participants, so a market facilitator will need to be close to the Capacity Market, development pipelines and connection requirements. This information should flow naturally from the RSP.

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

Whilst we acknowledge that the three main options for allocating the market facilitator role would seem to be the obvious first choices for consideration, it must be noted that each of these options comes with challenges in terms of establishing the role. For example, this would involve a lot of extra work for the FSO in addition to the existing scope that has already been identified. Consideration must therefore be given to the time, resource, and cost for the FSO to develop the appropriate skills and resources that will be required. Further consideration must also be given to the potential associated risks of having all these activities sitting within one, monopoly organisation who will be both accountable and/or responsible for a great deal of the future energy market's activities.

We agree with the need for the FSO to be regulated as a monopoly service provider and acknowledge the potential for conflict of interest within the FSO as buyer and market facilitator is significant. the materiality will depend on the design details of the markets and could be mitigated through ringfencing.

Regarding the ENA undertaking the role of market facilitator we agree with the limitations that have been identified within this consultation.

Furthermore, a precedent has already been set, with the industry seeing some DNOs venturing into the competitive markets with monopoly services that only they can provide. It is therefore difficult to see how this arrangement can be seen to be independent, that is one of the key principles of the market facilitator role.

The establishment of a neutral third party has its appeal as it could be established to meet all the key principles and criteria required. However, this is likely to be the most challenging of the three options being explored as it will presumably take to most time and possibly have the highest cost. We would therefore suggest that further consideration is given to this option to better understand the cost-benefit when compared to the other options, before moving to the next stage.

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?

Given the current, accumulated knowledge, skills and expertise that exists within prevailing organisations, it is difficult to see how the role of market facilitator, as envisaged by Ofgem, can be fulfilled by the extension of the activities of one organisation, given the time, cost and complexity that this approach would involve whilst meeting the key principles required.

One alternative that may be worth considering is to set the current requirements of the market facilitator role against the current energy landscape and the organisations that support these activities to establish if there is a possibility of developing a new independent body by pooling the necessary knowledge, skills and expertise from those existing organisations that are currently undertaking those activities. This approach could involve a long-term secondment, as with the current Joint Office model to ensure independence. At the very least, this approach may shed further light on how best to proceed to fulfil the market facilitator role.

5. Proposed governance reform: real time operations.

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

Yes, we agree with and support the proposal that the DNOs should retain responsibility for real time operations, as they are best placed to ensure that these activities are progressed both effectively and efficiently. However, an appropriate level of transparency will be required to reassure investors. This approach has the added advantage of maintaining the level of financial control that is required to ensure cost effective development of the networks via the current Price Control process and best value for consumers.

It is important that Ofgem's expectations on DNOs with regards to fairness and transparency with regards to real-time operations are clearly defined, testable and preferably quantifiable. These expectations should include users' views on the appropriate behaviour and perceived conflict of interests within DNOs. As local arrangements grow in scale and significance, Ofgem must be able to monitor and ascertain quickly whether DNOs are acting suitably, and consumer confidence is undamaged.

6. Next steps.

Appendix 1 – Impact assessment approach

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

We note that as the decision appears to have been made to progress the IA by setting the ‘effective governance’ archetype against the counterfactual, this may limit the responses that Ofgem may have otherwise received. Having said that, this option is one of only two options that were originally presented in the 2022 Cfl that, in our view, could conceivably fulfil all Ofgem’s proposals for improving local energy institutions and their governance. The other being that of Regional System Planner and Operator(s), that we believe also has merit and so for completeness should be included as part of the IA, or alternatively clear guidance should be provided by Ofgem as to why this approach was discounted.

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

As it has been stated, some of the benefits resulting from current Ofgem proposals may be realised under the counterfactual. For example, the development of a fully flexible and resilient energy system with improved demand side response, thermal storage to reduce electricity demand peaks, battery storage and inter-connectors will help to meet demand and reduce the need for large-scale back-up generation. Also benefits under the counterfactual could be realised regarding Data quality improvements, improved market participation of flexible resources, increased stakeholder confidence and transparent decision-making.

It would therefore be prudent for the benefit measures that are developed to be readily applicable to both the effective governance and counterfactual scenarios wherever possible. This would reduce the possibility of either missing or double counting a particular benefit for either option. Furthermore, this would also correctly account for those benefits that would otherwise accrue under the counterfactual scenario and so provide a more robust IA.

We agree that it will be difficult, in all instances, to accurately attribute all benefits and that in these circumstance, a low, medium, and high assumption approach would help to assess these. However, careful consideration will be needed when developing these assumptions and these must be clearly communicated to ensure that all interested parties are clear with the approach taken, and if required have the basis on which to further challenge those assumptions at a later stage, when potentially more information may be available. Such an approach will better ensure engagement with and confidence in the IA outcomes for all interested parties.

At least during the earlier stages of analysis, we would agree that benefit measures should be developed that assess those areas identified in A1.13. These will need to

be clearly defined and measured. It is imperative that if clear benefits are to be established then discussions should begin as soon as practicable, as the earlier these can be measured, the better the results obtained.

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.

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 most notable additional cost that will arise from sharing functions and as a direct result of the proposed new framework arrangements will be regarding the establishment of new lines of communication and the flow of new standardised data items. These will be required to obtain the benefits from improved data structures and the development of a new, single data repository, that we currently envisage will be the only way of ensuring for the provision and access to consistent data and information. These data requirements will presumably need to be accessible by all identified parties, that is, the FSO, all RSPs, all DNOs/ GDNs and all LAs, at the very least. The timescales required to establish these lines of communication will also need to be considered.

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.

Please see response to question 14 above.

We hope that this response provides you with the information that you require. However, please let me know should you require any further information or clarification on any aspect. Thank You.

Regards,

Mark Field
Regulatory Affairs Analyst
Sembcorp Energy UK Ltd
07766 422 807