

## Future of local energy institutions and governance

National Grid response to Ofgem's consultation

10<sup>th</sup> May 2023

**This response to the Ofgem consultation 'Future of local energy institutions and governance' dated 1 March 2023 (the Consultation) is from National Grid plc (NG), including our electricity distribution business, National Grid Electricity Distribution Holdings Limited (NGED), which owns and operates an electricity distribution network of 550,000 square kilometres serving nearly 8 million customers in the East and West Midlands of England, South West and South Wales. NGED is responsible for the regional distribution of electricity from the transmission network, providing a safe, stable and reliable electricity supply and ensuring the highest quality of customer service. It facilitates the connection of supply and demand customers to the distribution system and is investing to adapt and develop its distribution network to connect new sources of low carbon and green energy to homes and businesses in support of the transition to net zero**

The response consists of two parts:

- Part 1: Executive Summary, setting out our central messages in response to the Consultation
- Part 2: Our responses to the specific questions raised in the Consultation.

### **PART 1: EXECUTIVE SUMMARY**

We welcome the opportunity to respond to Ofgem's consultation on how future local energy institutional and governance arrangements can support regional decarbonisation. We are grateful that Ofgem is both seeking views on the proposals it has set out in the consultation and open to hearing further proposals and solutions about how to best facilitate coordination across the energy system.

A net zero energy system requires significant change across the network value chain, and as Great Britain's largest network company, we are dedicated to delivering for our customers efficiently and enabling the energy transition for all. We recognise the scale of change: for example in our distribution business we are preparing our network to accommodate up to 1.5 million additional electric vehicles and 600,000 heat pumps across the next five years.

We note there are related, ongoing consultations, in particular:

- **The Call for Input: The Future of Distributed Flexibility**, which discusses earlier stage thinking on digital enablers for flexibility for devices connected at a distribution level. This call for input is running to aligned timescales to the Future of local energy institutions and governance consultation and has aligned themes. Across our responses to both publications, we identify the roles and responsibilities across the energy system which we expect to best deliver flexibility markets which work for both consumer and network/system operators.
- **Future Systems and Network Regulation (FSNR)**, which is consulting on future network price control frameworks. We note that the decision from the FSNR consultation in early autumn will not extend to electricity distribution. As and when a decision is taken on the future price control framework for electricity distribution, it will be important that it works together with the future scope and role of the RSP. We note there is a difference in the role of the RSP as described in the FSNR consultation and this consultation. As we explain later in the response,

we believe the more appropriate role of an RSP is as described in this consultation, i.e. in providing direct local views into the strategic planning process and not as a commissioner of new network upgrades/projects.

In general, we recognise the strategic context and the case for change to the governance arrangements at the sub-national level as set out in the consultation document. We agree with your proposals for:

- The creation of a network of RSPs. We believe they should be a “federation” of autonomous RSPs, who operate independently but are institutionally part of the FSO;
- A single, neutral expert entity should coordinate market developments across distribution, transmission and the wholesale energy market; with a focus on coordination and standardisation; and
- DNOs to continue their role in real-time operations of their networks. In respect of Ofgem’s proposed governance reform for real time operations, we note that the role and needs align with the core competencies of a DNO, and therefore, it is in consumers’ interest for the role to continue to be fulfilled by DNOs who have the proven capability and experience. Therefore, we agree that DNOs should retain real time operation. We welcome your confirmation that Ofgem is not seeking to require DNOs to be legally separated into independent distribution system operators. DNOs can have certainty, and going forward, they can focus on continuing to provide smooth operation to consumers as well as, down the line, cross-fertilise knowledge experience. We have no further comment in relation to this reform proposal.

We recognise the significant benefits for consumers in the shift to a more flexible electricity system, which is managed and planned as part of a whole systems multi-vector approach, as reflected in the progress we have made over recent years in operating our network more flexibly. Our views are informed by our practical experience as we have been transitioning towards Distributed System Operation, for example:

- Our views on the benefits of standardisation and benefit of common specifications to remove barriers for Flexibility Service Providers (FSPs) are shaped by being the first DNO to provide full and complete access to flexibility requirements data via an API in 2021 and our adoption of the ENA Standard Flexibility Agreements to contract with our FSPs in 2020.
- Having created the first functionally separate DSO in 2021, we have learned about the complexity in managing real time operations in the changing context in our sector.
- Our thinking on energy system planning is informed by several years of developing and refining our approach, from our first long term scenario forecasts in 2015 to move to annually updated DFES scenarios since 2020 and our work with the ESO on Regional Development Programmes.

Our position is based on what we believe – informed by real life experience – will help to unlock the transition to DSO for consumers. While we agree in principle on the need for a Regional System Planner (RSP) and a market facilitator, we have a number of specific concerns in the detailed design of these new roles. Our feedback is aimed at maximising the benefits to consumers in how these changes are implemented, including the to the effectiveness of the new institutions and reduction or elimination of conflict of interest. We now discuss these two proposals.

## **REGIONAL SYSTEM PLANNER (RSP)**

We note that the description of the RSP in this consultation is very different to that described for the 'Plan and Deliver' archetype in the FSNR consultation, and this needs to be clarified as a matter of priority. Our response is based on the expectation that the RSP’s role proceeds as envisioned in the Future of Local Energy Institutions and Governance consultation (this consultation) rather than that

of FSNR. Should our interpretation be misaligned with Ofgem's, then we might hold a significantly different view and would need to revisit our position on the proposal.

To demonstrate where we see divergence between the two consultations, this consultation defines that the RSP is a coordinator who is accountable to the region and who would issue and be accountable for one regional plan, taking into consideration local perspectives and inputs across different energy vectors and would not be involved in granular electricity network planning. However, the FSNR consultation states that the strategic planner would be involved in granular planning as well as have ultimate responsibility for upgrades and project needs. Notably, this consultation states (emphasis added):

- 3.8: "...existing and other actors must remain responsible for planning activities aligned to their existing competencies. By this, we mean network companies would remain responsible for network planning activities, but these would need to align to the regional energy system plan (i.e. by using the same key planning assumptions)."
- 3.9: "The existing actors plan for their own assets and within their own competencies....proposing that the RSPs focus on their coordination and coherence: ensuring common starting points, facilitating dialogue and creating an independent strategic summary (the regional whole system strategic plan)."
- 3.10: The output of the RSPs would be a key input to the distribution price control setting process for the justification of system/network need."

In contrast, FSNR describes the strategic planner role as placing the (page 7) "ultimate responsibility for upgrades and new project needs with the strategic planners rather than the licensees" and (page 8) "involves granular planning" with (section 3.7) "national and regional strategic plans which are turned into clear and detailed descriptions of network needs...[requiring] government and developed administrations, independent system planners and Ofgem to work collectively, with some data, expertise and information provided by the network companies."

### The Role of the RSP

In creating the RSP, our approach is driven by the principle that clear allocation of roles based on each party's strengths will derive the best value for consumers. In our interpretation, that means the RSP is focussed on establishing the need; the DNO is focused identifying the most efficient solution; and Ofgem is focused on its economic regulation of the network companies.

There is an inherent gap between existing entities in providing clarity, coordination and alignment in the way sub-national energy system planning is undertaken across vectors and network owners, and we recognise the case for change in creating a new, neutral entity with the appropriate skills and capabilities to fulfil this role. The RSP would also reconcile differences at the regional level with other RSP as well as differences with the national energy system plan (CSNP). Currently there is no party with the mandate to take a holistic view of GB's sub-national whole energy systems.

We consider that this can bring consumer benefits in at least two ways. First, our interpretation is that a role of the RSP is to coordinate regional, cross-vector plans by joining them up, reconciling conflicts and offering alternative solutions from a whole system perspective to maximise consumer outcomes and benefits. In doing this, our expectation is that the RSP will engage with a number of parties, such as local authorities, and align the regional system plan to assist them in achieving their local policy objectives and decarbonisation goals. The RSP would issue one, consolidated plan and would be accountable for its accuracy.

Second, our interpretation is that, through the above-mentioned activity, the RSP would finalise a regional plan, and that this plan would serve to establish the system need. As the RSP is a neutral party without vested interests, it would be well-placed to prioritise the consumer. For local energy system solutions, it would then be up to the DNO to offer and determine the best pathways to meet those system needs and would continue to be incentivised to do so through RIIO-ED2. Although a topic more for the FSNR consultation, we expect the RSP's regional plan to confirm the need at an early stage which would then not be revisited by Ofgem during the allowance setting process. This would allow networks to make the necessary preparations to be able to make timely investments therefore ensuring new infrastructure is there ahead of time to ensure we play our role facilitating and in minimising the costs of the net zero transition.

The transition to the new institutional governance arrangements needs careful consideration from two perspectives. First, it is important that during the detailed design and transition that we continue to progress at pace the development of Distribution System Operation and that as necessary, proposals by DNOs, including through uncertainty mechanisms, are not held up pending the creation of the RSPs or them developing plans. Second, these are new roles and a capacity and capability development plan is needed for whichever organisation takes on these roles to ensure they can deliver them effectively. This needs careful consideration, given other pressures on the FSO to establish the necessary capabilities to discharge its other roles. Ofgem should consider setting a realistic target date for the start of any new arrangements which takes the need for capability building into account.

#### RSP Governance must enable autonomy of the RSP

We agree with Ofgem that of the possible entities that could undertake this role, the FSO (once it is established) would be best placed to fulfil this role, but clear governance structures which enable RSP autonomy are needed so that the RSPs fully represent the local interests of consumers. We envisage that the RSP will need not only to reconcile plans cross-vector within its own region, but also coordinate with other neighbouring RSPs' as well as the CSNP. For this reason, it is essential the RSP is autonomous. We offer the analogy of a federated structure including division of leadership, decision-making authority over one's regional plan, and equal negotiating/veto power when interacting with the central FSO.

We recommend the following governance design features:

- Clear, accountable leadership within the regional branches of the RSP
- Transparency of decision-making including regional engagement processes and decision-making criteria and publication of the outputs from RSP decision making
- Independence (from the FSO at a national level)
- Transparency of the processes for the incorporation of RSP findings into national plans (CSNP) including clarity on how the inputs into the RSP processes have had a demonstrable impact of the centralised national plans and how these deliver efficient outcomes for the local institutions and consumers
- Processes to resolve disagreement where the RSP and FSO are not in alignment

#### **The Role of DNO**

We expect the role of the DNO, in addition to network operation, extends to its responsibilities for network planning as stated in sections 3.8 – 3.10 of Ofgem's consultation document. We support aligning with the regional plan which the RSP would produce and to assist with that alignment, we would believe that network impact forecasting is a function which should remain with the DNO. We

believe this would be beneficial to users and consumers given the DNO's knowledge of its own network and the DNOs' experience in network forecasting.

### **Ofgem's Role**

The role of investment decision-making requires clarification. Our views are based on the expectation that the role of investment approval for network solutions would continue to be taken by Ofgem through the relevant RIIO-ED2 price control mechanisms. However, they would not reopen the overall needs case as identified by the RSP. In this manner, we recognise that Ofgem is best placed to protect the interest of current and future consumers.

We also ask that Ofgem clarifies the RSP's role and interaction with Ofgem. As outlined above, we believe that the RSP is well-placed to establish need. Ofgem can then take that plan and consider it to be the full contents of what is needed and proceed along with network companies through the price control to provide optimal solutions.

We do not expect the RSP would be involved in decisions on the investment cases such as performing detailed economic analysis and opining on which DNO proposed solution is the most efficient as this is not a capability that we expect the RSP will have. In this manner, we expect that Ofgem is the sole, independent decision maker for investment approval, drawing on expert inputs from other parties in the process.

We currently do not have a defined view on the specific geographical boundaries for the RSPs, but would expect RSPs to be at a sufficiently aggregated level to drive consensus for multiple local authorities and to not be constrained to existing political, geographic or organisational related boundaries. We consider the greater priority to be the governance design and the role specification. However, as a principle, it would appear to us to be in the best interest of consumers for boundaries to take a stakeholder view first (for example, setting boundaries based on national, regional and local government boundaries) and then as a second order, overlay energy system features as necessary. We welcome the opportunity to explore the practical challenges of setting the boundaries for the network of RSPs and we are happy to share our energy systems data to offer a view on where natural homogeneity exists between areas.

## **MARKET FACILITATOR**

### **A national and regional market facilitator**

We believe that a highly flexible energy system benefits consumers in many ways. For example, it will assist with renewable generation integration, which in turn promotes decarbonisation. We also support flexibility first to achieve local energy system needs through non-network solutions to keep costs down for consumers.

We recognise that flexibility integration has had challenges, and therefore agree that a market facilitator could help smooth a number of known hurdles. For consumers to benefit from potential reward across full-chain-flexibility, we suggest that a single, neutral expert entity should coordinate market developments across distribution, transmission and the wholesale energy market. Distribution connected assets could achieve more value for consumers if leveraged across the energy landscape.

We believe that the market facilitator role should focus on the governance and coordination across the key functions needed to define national and regional approaches once there is sufficient

understanding for the convergent standards and processes within that area to be developed and rapid innovation cycles are concluded. This includes:

- Data standardisation
- Rules implementation
- Primacy
- Stackability
- Settlement
- Opportunity visibility

### **Products and product specific rules to remain with the DNO**

While the market facilitator can reduce friction and enhance entry and operation, we believe it is important that product development and innovation remain with the DNO. This is because the knowledge and expertise of the facilitator would not extend to understanding each DNO's network challenges, so the facilitator would not be best placed to solve them, and so the facilitator would not be best placed to innovate. In contrast, a smart, data and digitally enabled DNO can identify emergent challenges on their system and propose products and trials ahead of scaling. Once a problem and solution is proven, it can be rolled out to the facilitator for confirming/standardising the specification for common use across the entire GB market.

We believe this approach would be consistent with the current commitments by DNOs to procure 80% of flexibility services across four standardised products. We expect these could be standardised / delivered to a common specification, while allowing DNOs to innovate and develop other services/requirements, the most successful of which we would expect to mature into more standardised services in line with market facilitator processes.

### **How to transition to the new arrangements**

It will take time for the market facilitator to ramp up. In the meantime, it is in the best interest of consumers for flexibility progress at pace. Across the entities considered within the consultation for becoming the market facilitator, we see all options as having some major issues which would need mitigation. Therefore, our preference is for, in the short-term, a resource commitment provided through Open Networks by the ESO and DNOs to continue, but with more purposeful implementation actions and outputs guided by stakeholder feedback and Ofgem and/or Government oversight. This would utilise the subject matter experts from networks who are supporting Open Networks but give the group a mandate to be able to move at a faster pace than is possible when working only through industry-led consensus.

We do not have a formal proposal for how this could be achieved in practice, however, we note that the consultation document does not include an assessment of the proposed changes to the Open Networks programme that were published in January 2023, which we believe could address some of the historic criticisms of the Open Networks programme. These changes need to be considered by Ofgem in designing the transitional rules.

There are a number of successful instances where Ofgem has taken a more proactive coordinating role on industry projects which could be considered to provide more focus and ability for Open Networks to progress at pace. For example, Ofgem and the Government's role on the implementation of the Smart Systems and Flexibility Plan or Ofgem's role on Project Nexus in driving industry to collaborate to deliver a challenging programme plan. We welcome the opportunity to explore different ways to accelerate Open Networks while retaining the subject matter expertise and positives of how the programme currently works. In particular, ...

This can be then handed over during a further, phased approach to the entity taking up the Market Facilitator role.

## **CONCLUSION**

We thank Ofgem for the opportunity to respond to the proposals in this consultation. We are keen to remain engaged with the regulator and are available to continue the conversation and to work with Ofgem in defining the ultimate roles and responsibilities of the RSP and its governance structure. We would further welcome discussion on the Market Facilitator model and how Open Networks can a more robust pathway to keeping the pace of change until the Market Facilitator is established. Should you have any questions about the points raised in this consultation, please contact Benjamin Godfrey, Direction of Distribution System Operator, via [bgodfrey@nationalgrid.co.uk](mailto:bgodfrey@nationalgrid.co.uk).



## **PART 2: RESPONSES TO THE CONSULTATION QUESTIONS**

### **1. 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?**

Yes, we agree with the proposal to introduce the role of Regional System Planner who would take on accountability for regional energy system planning activities. There is a clear need for greater coordination of investment across energy system infrastructure, and further action needs to be taken to fully embed whole system considerations across the totality of the energy system.

Through the most recent RII02-ED2 settlements, we have seen that the consideration of setting network operator investment levels based on company-specific business plans against different future pathways is not best supporting coordination in reaching net zero. Current uncertainty across net zero pathways has not provided the confidence for the regulator to sanction strategic investment to the level which is needed for a smooth transition and whilst mechanisms for moving investment allowances across network operators exist, they have not been activated due to the low levels of allowances for anticipatory investment. An important contribution which the combination of RSPs and the FSO-developed CSNP could make is to “lock-in” a view on how the energy system, including transmission and distributions need to develop ahead of need, moving away from a short-term focus on network costs to a holistic view on anticipatory investment needed to deliver net zero and reduce the overall energy bill cost for consumers.

Energy system planning across generation, storage flexibility and network infrastructure needs to account for the regional context, while also feeding into national level planning to ensure the UK, as a whole, meets net zero. National and regional energy system plans need to work together to ensure net zero ambitions are achieved at all levels, and follow the most efficient pathways possible

We therefore agree with the creation of an RSP role. As discussed later, we believe this should be as a “federation” of autonomous bodies, housed within the FSO. This separation will be important to ensure conflicts of interest are managed and that RSPs remain accountable to their local stakeholders. The RSP would have sub-national accountability for developing a regional energy system plan which reflects local stakeholders’ plans, for example local authorities Local Area Energy Plans and ensuring they integrate with other RSPs plans and the overall national plan developed by the FSO. This should help coordinate actions of key stakeholders to develop a pathway that meets net zero and does so in an efficient and cost effective manner, giving consideration to the likely incurred costs should other credible net zero pathways be realised.

The RSP must have a central focus on driving consensus within whole system planning at a regional level and be empowered to act across vectors. It must be independent (of other RSPs, the FSO and energy networks), being able to sufficiently challenge the thinking of other branches of the RSP, the FSO, network operators and the regulator.

The RSPs should develop and own the critical local energy planning assumptions which inform regional energy system plans. These would need to be cross-checked with national level plans to ensure consistency. When considering the critical power planning assumptions which would inform the network impacts, the peak demand assumptions should be owned by the relevant network operators, but the RSP may have a role in driving consensus or explaining the regionality.

The RSP should provide technical advice to support decision making across energy vectors and their respective price control planning windows.



We welcome the recognition that existing actors need to remain responsible for planning activities aligned to their competencies. We also recognise the need for interaction between the RSP's energy system plan and network operators' investment plans, ensuring there is a coherent starting point and a coordinated future trajectory.

## **2. What are your views on the detailed design choice considerations described?**

We agree with Ofgem's view that accountability and coordination across whole system energy planning needs to be improved, and we would see the RSP as having a central role in taking this forward.

In our view, an essential design choice would be that the RSPs are federated actors, having sufficient autonomy at a regional level, whilst being coordinated under a single entity nationally.

Establishing the RSP as a single source of the truth for a region's energy system requirements is a sensible step. However, the RSP should be sufficiently independent to challenge existing views, to identify synergies or conflicts across vectors and also to highlight where existing investment strategies fall short of supporting all credible net zero pathways. Equally, we would expect the RSPs to be open to challenge from others.

Out of the entities identified within this consultation, we agree that the leading organisation to undertake the role of the RSP is the FSO. To remove any perception of cultural bias towards centralisation and to ensure accountability to local stakeholders, the RSPs should be established in a way which embraces a high degree of decentralisation, which would best support the regional interests of consumers which each RSP represents. This includes the need for the FSO to establish regional branches and locate them in the areas they represent, embedding the RSP within that locality. Furthermore, the RSP must be purposefully and wholly resourced to deliver the functions of the RSP rather than be established as a devolved locale of a centrally managed organisation.

To maintain sufficient autonomy within the branches of the RSP, they must have an organisation governance that includes:

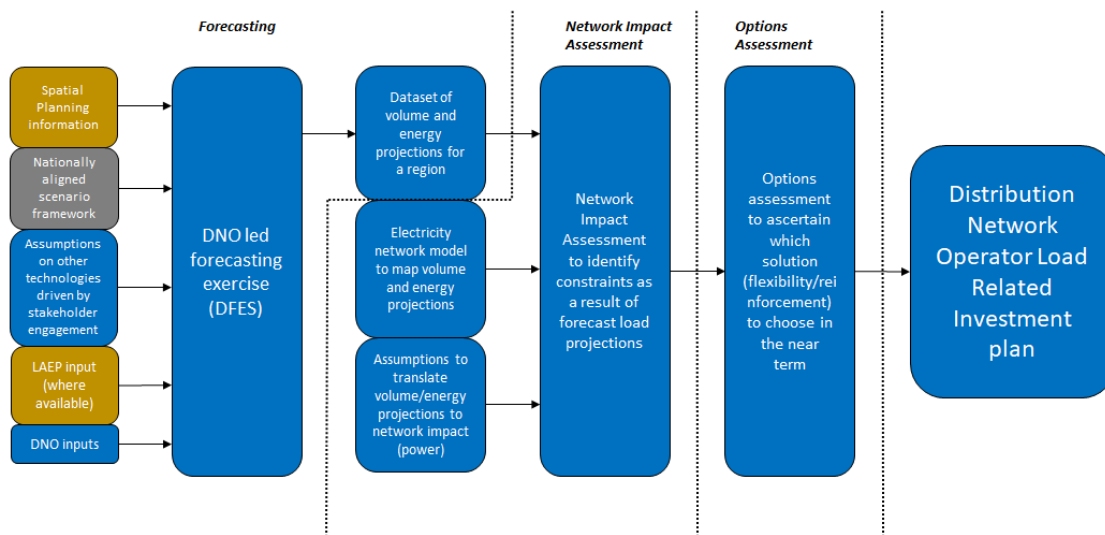
- Clear, accountable leadership within the regional branches of the RSP
- Transparency of decision-making including regional engagement processes and decision-making criteria and publication of the outputs from RSP decision making
- Independent (from the FSO)
- Transparency of the processes followed for incorporation of RSP plans into national plans (CSNP) including clarity on how the inputs into the RSP processes have had a demonstrable impact of the centralised national plans and how these deliver efficient outcomes for the local institutions and consumers
- Processes to resolve disagreement where the RSP and FSO are not in alignment

The branches need to be fully independent and sufficiently empowered to provide meaningful challenge to each other and to the part of the FSO responsible for transmission gas and electric planning. Routine engagement and transparent debate across the energy system planning space will strengthen the quality of the outputs as well as outcomes for consumers.

Current governance arrangements leave two significant gaps that need addressing; individual network companies plans may not be well aligned on a regional basis to deliver future consumer needs and

uncertainty around regional needs makes it challenging to consider future network investment efficient. With network companies responsible for much of these processes, adjudication of coordination across vectors and efficiency falls to the regulator across different price control assessment periods.

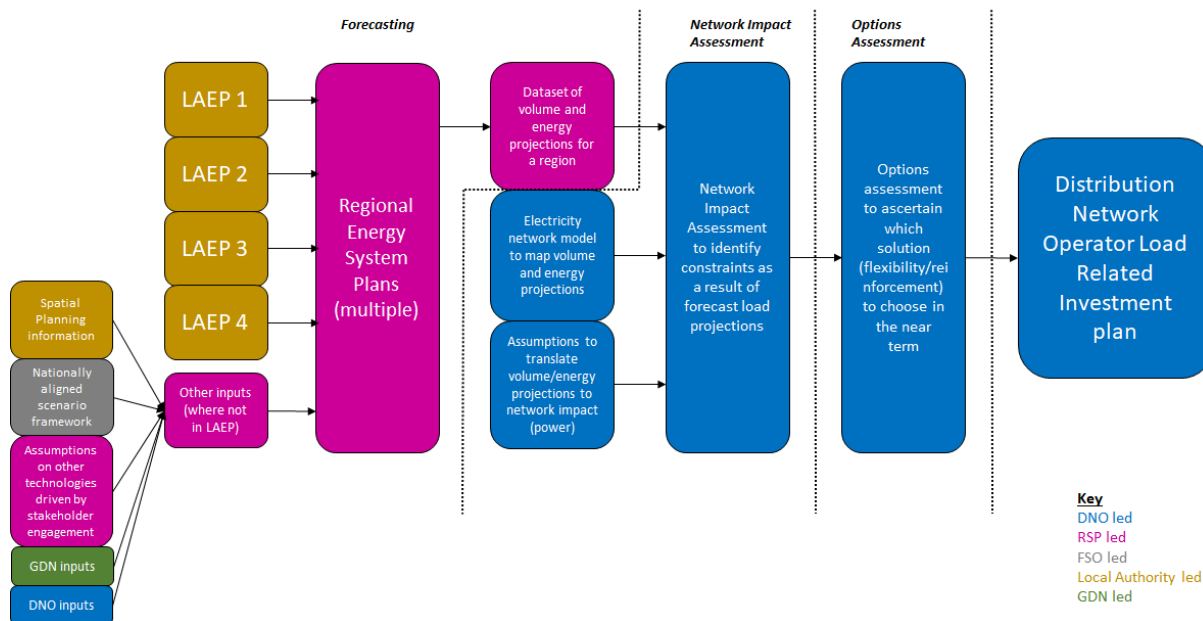
Current process for DNO load related investment planning (colours relate who does each step)



**Key**  
DNO/DSO led  
ESO/FSO/Open Networks led  
Local Authority led

By creating a new cross vector, local regulated entity to help address these gaps, the evidence to support the whole system investment need would be independent and future network investment could be more clearly defined as efficient, simplifying the roles and responsibilities across all parties.

Response to 'Future of Local Energy Institutions and Governance' Consultation (colours relate who does each step)



**Key**  
DNO led  
RSP led  
FSO led  
Local Authority led  
GDN led

### **3. Do you have views on the appropriate regional boundaries for the RSPs?**

We agree with the need for an independent regional system planner role and also that this RSP should be a single, regulated entity, with regional branches to provide increased localism. Evolving the RSP in this decentralised approach would embed a local, democratic planning mandate, including incorporating any LAEPs (where available) within these regions.

We recognise that the consensus needs of local stakeholders should be the greatest consideration when drawing boundaries and that network operators should expect to interact with multiple branches of RSPs within their licence areas. We do not expect this to cause additional burden as the interactions between network operators and different RSP branches should have full uniformity given the RSP is single entity.

Therefore, as a principle, it appears to us to be in the best interest of consumers for boundaries to take a stakeholder view first (for example, setting boundaries based on national, regional and local government boundaries) and then as a second order, overlay energy system features as necessary. To enable an effective RSP structure, it is essential that appropriate regional boundaries are drawn which consider the homogeneity of energy needs within a particular area and would allow for a single aggregated view to drive consensus across multiple local authorities at the RSP level. Through preparation of our DFES outputs, we have supporting data that could be used to inform the geographical boundaries once there is clearer definition of the benefits case for the granularity of regions and would be keen to work with Ofgem and other key stakeholders to derive these regions.

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

We believe the FSO has the potential to be the organisation which houses a network of RSPs, although they do not currently have the capabilities to deliver this role and Ofgem needs to consider what a realistic transition plan to the new arrangements should look like which allows the necessary capabilities and capacities to be developed.

Whilst the ESO has some experience for Electricity Transmission strategic planning, the FSO is nascent in its journey to ingest Gas Transmission strategic planning functions. It also has limited involvement in distribution level planning. More generally, the ESO is still in the early days of the transition to becoming the FSO with the broader range of accountabilities, governance arrangements and processes to be able to take on those roles which are already defined for the organisation.

Therefore, when establishing an independent regional energy planning function, it must be capable to fully consider and capture the regional energy needs and empowered to set out a strategy to coordinate activity to achieve this. If this is to be delivered wholly within the FSO, there needs to be clear independence between the bottom up and top-down elements of the energy system plan, including processes to resolve disagreement.

There needs to be an ecosystem based on agreed, broad principles which recognise the competences, activities and responsibilities across those interacting actors to reduce duplication and minimise conflict. We would welcome the opportunity in supporting Ofgem when clarifying on the proposed arrangements and handovers between network operators, regional stakeholders, Ofgem itself and the RSP/FSO.

There has been some demonstrable and mature progress in some sectors within this space. The Distribution and Transmission electricity system Future Energy Scenario work has evolved so that both systems use a common industry framework, with common building blocks for technologies, which both follow an annual staggered publication cycle with full coverage across GB. We feel this process could easily be adapted to consider a single RSP energy system planning scenario.

The Distribution Future Energy Scenarios (DFES) have been developed by networks in a desire to be more strategic and to more accurately reflect local consumer behaviour. However, so far, it has been challenging to get the required inputs from local authorities. Such bodies would need to develop significant additional capabilities to provide the necessary inputs alongside inputs from generation developers, major industry and other stakeholders to develop local area energy plans with sufficient depth and confidence.

We would see data standards and digitisation of the interactions between local actors, the RSP, FSO and network operators as being a key enabler of efficient energy system planning activities.

**5. 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 entity to take on a central market facilitation role and agree that this independent function should accelerate open and transparent markets that are unbiased by the commercial interests of the buyer.

The UK has a well-developed energy market, with both national and local markets embedded into the operation of the system, however we agree there are two key areas where we think a market facilitator could add value:

1. The market facilitator could better support standardisation and simplification to reduce friction for market participants and have a clear remit for accelerating improvements across the whole system
2. The market facilitator could be responsible for developing and owning market rules around co-optimisation, “stackability” and primacy across the whole system

In improving standardisation, simplification and value coordination, markets would develop in such a way which would enable smaller scale assets to participate on a level playing field with larger assets across the whole system. Standardisation and coordination more generally will improve access for all providers and we believe could make a significant difference to the development of flexibility markets.

We, along with other DNOs, have signed up to procure 80% of flexibility using four standard products by December 2023. However, the market facilitator should not be responsible for the specification of all products as this sits best with the DNOs and DSOs who have the detailed technical knowledge of their networks and use the products. This would allow for more innovation to meet future system needs. Given any products would be developed using a common set of underpinning specifications, we believe they would be accessible and understood by flexibility service providers. Over time, as products mature, there could be a case for a degree of further standardisation by the market facilitator.

The consultation has an immediate focus on distribution network management, which we believe too limited in scope. A single, neutral expert entity must coordinate market developments across distribution, transmission and wholesale energy markets. There is significantly more value for

distribution connected flexibility providers if they are able to provide services across the whole energy system, which required other sectors to be more accessible and stackable.

Given the existing maturity and innovative progress of both national and local energy markets in GB, there needs to be careful consideration on how the role of market facilitator is introduced and who undertakes this function.

Across the entities considered within the consultation, we see all options as having some major issues which would need mitigation, as discussed in our answer to question eight.

In considering the future governance arrangements, it will be essential to build on existing work to ensure that current market arrangements are not undermined, market development continues at pace and that progress does not stagnate.

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

We broadly agree with many of the allocated roles and responsibilities set out in the consultation. However, in recognition of our earlier position in question 5 that the Market Facilitator should have a wider role of coordination across the whole energy system, the lens portrayed in Table 2 needs to be expanded to consider not just the DNO interactions, but also those across ESO/FSO, aggregators and the retail wholesale market.

On the detail provided in Table 2, we have identified some of specific examples which we believe need more delineation:

- **Product Development & Standardisation:** Whilst the consultation has product development and standardisation as single task assigned to the Market Facilitator, we would see a greater role for the DNO in defining and developing the products to ensure they deliver the technical requirements. However, we see standardisation being the mandate of the Market Facilitator. Within Open Networks 2023, all DSOs have committed to procure over 80% of their system needs through the standard products. We would see similar commitments ensuring the majority of the value of distribution flexibility markets is standardised, without removing the ability for innovation and agile development of products by DNOs.
- **Managing Market Rules:** We agree that the Market Facilitator would manage the market rules, but we would also see an associated role for the DNO and FSPs in suggesting improvements to market rules to achieve better outcomes for consumers and for the network. A process and pathway should be formalised to enable stakeholders to improve market rules.
- **Engaging with Market Participants:** Whilst the Market Facilitator might do some of the engagement with individual flexibility providers, we would expect much of the interaction to be undertaken by the platforms operated by DNOs and aggregators rather than the single neutral expert. This reflects the level of sophistication of many flexibility providers, who are often providing services which are ancillary to their core business and are likely to work with aggregators as the interface into the energy system. As DNOs will continue to run platforms, they will have existing relationships with market participants.
- **Pre-qualification:** We would expect the Market Facilitator to design and agree the standardised process, but for the actual pre-qualification activity to be undertaken by the market enabling infrastructure and platforms as they are best placed to deliver and operate

the digital infrastructure. Some elements of this will also be supported by aggregators, working in conjunction with the market enabling infrastructure and platforms.

- **Evaluating and Selecting Options:** We wish to highlight the significant dependency on “Evaluating and selecting options” and “Managing Market Rules”. Service selection of trades offered to the network/system operators will be highly dependent on the economic cost and risk trade off. The market facilitator should have a sole focus on whole system cost optimisation, whereas procuring system operators will be focussed on their own cost and risk minimisation.

Table 2 provides a high level, simplified view applicable for the most simple of use cases for distribution flexibility markets. In Ofgem’s other consultation on the digital enablers for flexibility markets, a much wider set of use cases is identified. We feel this work on roles and responsibilities would benefit from these use cases being tested against the proposed roles of the actors to highlight some of the nuances around the design of the market facilitator. We anticipate the role of the market facilitator would evolve as it increases in maturity, so a transitional approach might be most appropriate in the short term.

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

Whilst the consultation has product development and standardisation as a single task, we see this as two, distinct activities undertaken in a coordinated process by different entities.

Table 2 is also missing entries on escalation and governance of the market facilitator should it not achieve the outcomes it needs to for DNOs, FSPs and the FSO.

#### **8. What are your views on our options for allocating the market facilitator role?**

We agree that more work is needed on improving the coordination between distribution and transmission flexibility markets. We agree that a Market Facilitator would potentially catalyse improvements in coordination, standardisation and simplification.

Whilst the ENA operates through a consensus mandate across its members, it should be clear that its membership extends across DNOs and the ESO. Therefore, it is well placed to coordinate activity across the network and system operators. Whilst the complexities of local flexibility markets need to be addressed by the DNOs, the difficulties of revenue stacking of flexibility markets are both a DNO and ESO issue, with much of the revenue stacking issue relating to the inherent complexity and mutual exclusivity between other ESO markets and DNO/ESO constraint management markets. Open Networks, as an existing conduit for leveraging innovation and embedding standardisation and coordination in flexibility markets, could provide a springboard for future governance arrangements. It has proposed improvements to how it works in January 2023, which Ofgem should consider in developing the approach to transitioning to the future market arrangements.

However, there is a great need to ensure coordination of energy markets is not just a network/system operator activity, but that it is also embedded across wholesale retail markets and broader energy vectors such as hydrogen. Neither the ENA nor the FSO hold sufficient expertise, membership or authority to achieve this.



We agree that the ESO holds some competencies for designing energy markets and so the FSO could be a potential candidate, however we have concerns which we believe need to be considered further if the FSO were to take on the market facilitator role:

1. **Impartiality:** As the predominant procurer of flexibility services across the energy market, the FSO would be conflicted between its role as a market buyer and as a potential candidate as an independent market facilitator. The ESO flexibility markets team is effectively a flexibility procurement team for the system operator. If it becomes the de-facto market facilitator, then it would need to take a position of independence when considering governing products, including important independent roles such as primacy and stackability.
2. **Approach to decentralisation:** Flexibility is expected to be achieved from within distribution networks via aggregation of smaller units, whereas the ESO has more experience and a greater interest with >50MW generation units, which may bias approaches to flexibility procurement.
3. **Democratic Mandate:** The ESO has experience on holding national positions which may be an impediment to providing authenticity of representing the needs of local areas. One of the key benefits of the RSPs is to bring a sub-national perspective on energy system planning and retaining local accountability will be an important feature.
4. **Exclusivity requirements:** The ESO currently demands exclusivity in its flexibility procurement, which means an FSP cannot offer its services to both ESO and a DNO. This approach does not signal confidence that the ESO will increase stackability among DSO products, which were designed to be stackable. Furthermore, ESO's current approach could result in slower stackability across regional and national products.

As the ESO transition to FSO isn't expected until 2025, and there would need to be sufficient time for the new organisation to develop the necessary capabilities and capacity, there would still be a time lag before the FSO could be mobilised to undertake the activities required.

A neutral third party is another option which would be truly independent and could lead to a more successful, unbiased implementation body. However, we recognise the time that would be needed to create this entity. Once created though, this body could be responsible for market development across both transmission and distribution, creating a single entity fully responsible for whole system coordination of energy and flexibility markets. Whilst this would be more difficult to establish in the short term, it may ultimately address the conflicts of interest that persist in the other entities.

In the meantime, we think the ENA Open Network programme is a viable body – with some important changes to governance – that can progress thinking on these issues, while Ofgem explores further the advantages and disadvantages of different long term reform options. We think making progress in the immediate future is as important as considering the long-term arrangements.

Whilst the ENA Open Networks has both ESO and DNOs as members, the ability to recommend and implement convergence and standardisation has been limited by its lack of accountability. It has further been limited from achieving greater convergence over the past two years due to the competitive nature of the RIIO-ED2 price control process. However, in the short term, implementation could be more strongly supported by Ofgem through a range of mechanisms, including plating a greater coordination/sponsorship role or through making changes to SLCs e.g. DNO SLC31E or ESOs SLC16A, providing the accountability for implementation back to the DNOs and ESO. Further options for improvement could be seeking more resource allocation from the member companies, or a stronger, empowered chair having overall delegated decision-making authority.



**9. 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?**

All the options laid out in the paper have various merits and drawbacks. A combination of options is most likely to enable the existing progress to be continued at pace, whilst improvements to facilitate convergence across the longer term are implemented.

Our preference is for, in the short-term, the resource commitment provided through Open Networks by the ESO and DNOs to continue, but with more purposeful implementation actions and outputs guided by stakeholder feedback and Ofgem oversight. There are a range of examples of Ofgem playing a proactive role in driving industry collaborative processes, including licence conditions to proactively establishing and chairing governance processes to focus industry and help drive consensus and progress. We would be happy to explore such options with Ofgem in the coming months.

Ultimately work undertaken by Open Networks can be handed over during a further phased approach to either an independent third-party implementation body responsible for whole system coordination of energy and flexibility markets, or the FSO with appropriate governance, independence from FSO procurement functions and routes for escalation.

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

Yes, we agree that DNOs should retain responsibility for real time operation. This is in the interest of consumers, as there is a safety and resilience case for the DNOs, as the entity with the most knowledge, capability and experience in this area, to retain this role.

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

Establishing a baseline counterfactual using the current ED2 trajectory seems a sensible step. However, the current low baseline for system investment – as a result of decisions Ofgem has taken in setting ED2 allowances linked to scenarios for the uptake of low carbon technologies - should not take into account any investment from uncertainty mechanisms.

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

The areas identified for quantitative assessment seem representative and many of the areas highlighted below would demonstrate a positive measure should the recommendation we outline in our response be enacted. We have outlined a few relevant examples in the list below, but would welcome further engagement to support this activity:

1. Flexibility (provision, connections, synergies)  
*Connections would be within the control of the DNO so there is more opportunity to optimise general load related investment alongside connections-led reinforcement if both are considered within the network company. As similar opportunity exists for asset replacement activity.*

2. Data quality improvements  
*A federated RSP could be objectively measured in the improvement impact it has on the data quality of LAEP data and network company data.*
3. Improved market participation of flexible resources  
*Retaining the ability for DNOs to trial innovative products which better meet their system needs alongside the standard flexibility suite could support a more optimum pathway for harnessing flexibility more efficiently.*
4. Deferred reinforcement/decarbonisation synergies  
*Deferral of one investment plan could be linked to the acceleration of another, should that decision be determined efficient. Pulling forward or deferring the investment recognising the carbon counterfactual will ensure decisions take into account the full whole system impact.*
5. Transparency of decision making  
*A federated RSP would have transparency of the decision making process linking their inputs to the outputs it recommends and then a further transparent stage where these are assessed for prioritisation and coordination at a national level.*
6. Increased stakeholder confidence  
*Transparency of interactions and autonomy of the RSP within the FSO should enable stakeholders to grow in confidence that the entities responsible for the different activities are working in the best interests of all parties.*
7. Whole system benefits  
*Embedding the coordination between network investment plans within the RSP should drive the right signals for investment where it is justified by regional stakeholders. One suggestion for the governance of the market facilitator could be for it need to assess the whole system benefits ahead of making changes to arrangements.*

**13. 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 have undertaken no prior work in that area.

**14. 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 areas of activity which are likely to introduce new costs are those areas which involve undertaking missing activities, those that involve duplication of existing functions and those that cover additional interactions between entities.

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

Additional costs would be difficult to quantify, but some areas which may require further exploration would be:

- Additional stakeholder engagement
- Inter-organisational communication
- Reconciliation across different reporting timescales