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

Dear Joseph,

Market facilitator delivery body

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

The Future System Operator (FSO) and Elexon are not easily comparable, for the purpose of appointing the Market Facilitator (MF) delivery body. Both organisations perform different roles in the energy system, sometimes exhibit different behaviours and have expertise in different areas. However, neither organisation is currently wholly capable of successfully fulfilling the role. Each organisation appears capable of developing the relevant additional competencies and behaviours and, therefore, either organisation could reasonably be appointed as the delivery body.

In this instance, selection should not be based primarily on the existing capabilities of or industry's experiences with either organisation. The more important distinguishing factors are how each organisation can be encouraged to deliver high levels of performance and be held accountable.

- **Regulatory frameworks should first be assessed, to inform the selection of the delivery body.**
- **The 'rulebook' should be codified.**
- **Implementation can be progressed at pace.**

We explain these issues below.

Regulatory frameworks should first be assessed, to inform the selection of the delivery body:

Both the FSO and Elexon would need to improve some existing capabilities and develop relevant additional competencies and behaviours to effectively undertake the MF role. Either organisation

could reasonably be appointed as the delivery body if technical capability is the only criterion. We think the most important criterion should be the effectiveness of each organisation's regulatory framework to:

- drive the organisation to deliver high levels of performance;
- drive the organisation to develop relevant additional competencies and behaviours as quickly as possible;
- encourage open and collaborative decision-making that fully involves and is transparent to stakeholders (including flexibility service providers (FSPs)); and
- hold the organisation accountable.

The need to introduce the MF is due to the ineffectiveness of the current informal arrangements to prevent market friction, to deliver coordinated flexibility markets and to deliver arrangements that allow FSPs to participate in and 'stack' revenues from multiple markets. The current informal arrangements have failed to prevent the lack of progress made by the Open Networks Project (ON). The current arrangements have also not held Distribution System Operators (DSOs) to account for failing to implement the ON output in a standardised way and for failing to sufficiently standardise flexibility markets. The current arrangements have failed to encourage ON to develop rules that coordinate instructions to FSPs from DSOs and the Electricity System Operator (ESO), to allow revenue 'stacking'. These issues are well known and are recognised by Ofgem.¹ We, too, have raised concerns about market friction and have encouraged Ofgem to mandate that the DSOs standardise their flexibility markets.²

The FSO and Elexon will be governed by different regulatory frameworks since they are based on different operating models. The effectiveness of the different regulatory frameworks to drive the right outcomes may be dictated by the characteristics of the respective operating models. Both organisations will be operated on a not-for-profit basis. However, the FSO will be a public corporation and will be licensed while Elexon is not a public corporation and is not licenced. It is premature to select the MF delivery body without first identifying which set of arrangements is likely to be more effective.

We believe it is necessary to first conduct a detailed assessment of the effectiveness of the regulatory models, to inform the selection of the delivery body. We have already explained why the FSO's proposed regulatory framework is likely to be much less effective than anticipated and why it should be strengthened.³ The revised arrangements that would apply if the FSO is appointed as the delivery body should be compared to the arrangements that would apply if Elexon is appointed. That comparison should then be used to inform selection.

It is not in consumers' or market participants' interests if the future arrangements do not represent a significant step-change in effectiveness, compared to the current informal arrangements involving ON that have proven to be ineffective. Future market arrangements must not allow DSOs to develop differing rulebooks or to implement the rulebook inconsistently. Future market arrangements must achieve the desired levels of standardisation, efficiency, coordination and compliance.

¹ "Future of local energy institutions and governance"; paragraph 4.15.

² During the RIIO-ED2 price control review.

³ In our response to the consultation on the policy direction for the FSO's regulatory framework.

The ‘rulebook’ should be codified:

The ‘rulebook’ should be codified (incorporated into a multilateral industry agreement) regardless of the organisation that is appointed as the MF. The ‘rulebook’ means the processes, rules and standards that are required for the efficient and coordinated operation of flexibility markets and which the MF will develop, maintain and monitor compliance with.

Under the current informal arrangements, ON has been developing flexibility processes, rules and standards. Each DSO then produces its individual rulebook that is based on, amongst other things, the ON output. The ESO also maintains its own rulebook. The multiplicity of different rulebooks is a primary source of the friction that FSPs face when operating across multiple regional electricity distribution areas and across network levels.

Codifying the rulebook will reduce market friction:

Codifying the rulebook allows binding obligations to be placed on parties in flexibility markets to operate in a standardised manner. For example, there could be standardised obligations on the DSOs to publish clear requirements for flexibility sufficiently ahead of procurement. There could also be standardised obligations on FSPs to deliver volumes according to a defined standard. Standardisation allows for more effective compliance monitoring and enforcement.

An industry code is an effective way of achieving standardisation and thereby reducing market friction. An industry code is also well suited for governing multi-party markets (such as flexibility markets) where trades between parties create obligations to deliver a service or commodity to a defined standard and create obligations to remunerate the providing parties. This is because a code enables:

- standardising rules for trading and delivery;
- specifying rules for ensuring that the activities of a market participant do not detrimentally impact other market participants (or for providing compensation where this is unavoidable);
- facilitating proper consideration and treatment of the interactions between different products and processes;⁴
- facilitating timely and consistent settlement of trades;
- establishing standards and mechanisms for monitoring performance;
- establishing clear processes and bodies for managing and resolving disputes; and
- allowing more efficient and transparent administration of the arrangements (instead of the resource burden and opacity associated with amending bilateral arrangements).

We also expect that the rulebook being codified may make it easier for new entrants to navigate the arrangements, thereby lowering the barriers to market entry and participation.

⁴ This is an issue the ON ‘primacy’ workstream tried to address but has not made satisfactory progress.
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Codifying the rulebook promotes open and transparent governance, thereby increasing accountability:

An additional benefit of codifying the rulebook is the increased accountability required of the MF, particularly in relation to its decision-making. The typically open and transparent governance arrangements that are associated with industry codes should lead to an increase in the quality of decision-making because decisions must be explained, justified and evidenced.

It is also our experience that poor decision-making can occur when informal arrangements (such as the arrangements relating to ON) do not hold organisations to account. As an example, the ESO developed the Balancing Reserve Service (BR) to reduce the costs of managing the electricity transmission system.⁵ The ESO's first submission for approval was rejected by Ofgem, in part, because of the discriminatory elements of the proposal.⁶ Several market participants raised concerns about the discrimination, but the ESO submitted it for approval nevertheless. The ESO's second submission reflected feedback received ahead of the first submission. We provide additional detail in the attached appendix.

This is not an isolated occurrence. Another example is that the ESO eventually revised the design of the Dynamic Containment (DC) product to allow aggregation at the Grid Supply Point (GSP) group level, after having introduced the product with group level aggregation but then restricted aggregation to within individual GSPs. Restricting aggregation to within individual GSPs made efficient aggregation unnecessarily difficult but without any material technical or system benefit.

These situations are not simply inconveniences to market participants. Both situations are likely to have resulted in some of the benefits to consumers of the new service/product being lost because of delays that were, in turn, caused by poor decision-making. Both situations caused uncertainty and may have had a negative impact on investor confidence.

We recognise the need for the MF to be agile. However, our experience is that an implicitly singular focus on agility can lead to undesirable consequences such as poor-quality decision-making, benefits to consumers being lost and markets appearing less attractive to investors. The informal arrangements relating to ON, or to the ESO designing system management services, allowed for agility but there has been a lack of progress (in the case of ON) or some poor outcomes (in the case of the ESO). These eventualities could have been mitigated had arrangements that drive higher levels of accountability been in place. We believe that codifying the rulebook will strike an appropriate balance between agility and accountability.

The rulebook should be incorporated into the Balancing and Settlement Code:

The Balancing and Settlement Code (BSC) contains the rules that govern electricity trading and settlements in the GB market. Although flexibility markets involve the trading of flexibility rather than energy, there are numerous interactions between flexibility markets and the wider electricity market. These interactions highlight why it is necessary that the rulebook should be incorporated into the BSC. This would allow for the impact of an FSP's activity and flexibility trading on wider electricity market participants to be fully accommodated.

⁵ See: <https://www.nationalgrideso.com/industry-information/balancing-services/reserve-services/balancing-reserve>.

⁶ See: <https://www.ofgem.gov.uk/publications/decision-reject-amendment-terms-and-conditions-related-balancing-relation-proposed-balancing-reserve-service>.

The BSC already includes some rules that take account of flexibility trading. For example, the BSC was recently amended to allow FSPs to trade flexibility in the wholesale market.⁷ A key feature of that modification is the explicit acknowledgement that actions taken by FSPs affect suppliers' traded and notified positions. As a result, an adjustment and compensation mechanism was incorporated into the BSC. Another modification has been proposed that seeks to implement a similar mechanism, to account for the impact of FSPs participating in the Balancing Mechanism.⁸ The amendment and the modification both specify the rules for quantifying the impact of FSPs' actions on suppliers, the data used to make the necessary adjustments between parties and provide mechanisms to support the resulting cashflows.

Incorporating the rulebook into the BSC would be merely an extension of what is already happening: ad-hoc amendments are being made to the BSC to accommodate flexibility trading. These ad-hoc amendments are being made to correct discrete issues. Instead, a holistic approach should be taken to ensure that the BSC fully takes account of how flexibility markets interact with the wider electricity market. Incorporating the rulebook into the BSC will ensure that the BSC fully takes account of interactions between ESO and DSO markets and how flexibility markets interact with the wider electricity market. Incorporating the rulebook into the BSC will also allow FSPs' actions that have a detrimental impact on participants in the wholesale/retail market to be more easily identified and adjusted for in a coherent and consistent way. It is unclear how these detrimental impacts would otherwise be identified and treated if flexibility market rules are set out in a series of bilateral agreements between each DSO and FSPs.

Implementation can be progressed at pace:

Implementation of the MF and flexibility market arrangements can continue at pace. Our recommendations - that the regulatory arrangements should be assessed (to inform the selection of the MF delivery body) and that the rulebook should be codified – should not have a material impact on implementation timescales. We consider the relevant major milestone of the implementation programme to be that point in time at which flexibility markets are being operated in a largely, if not exclusively, standardised way.

Our position is based on Ofgem's commitment to be more actively involved in ON to prevent a hiatus in activity⁹ and, so, the development of the rulebook should continue at pace. We welcome Ofgem's intention to provide steer on regulatory and policy issues.¹⁰ We expect that Ofgem's involvement in ON should help to resolve some issues, such as primacy rules, that the project has yet to make satisfactory progress on.

There are five main implementation activities, including the activities that we have recommended:

⁷ BSC P415 'Facilitating access to wholesale markets for flexibility dispatched by Virtual Lead'. See: <https://www.elexon.co.uk/mod-proposal/p415/>

⁸ BSC P444 'Compensation for Virtual Lead Party actions in the Balancing Mechanism'. See: <https://www.elexon.co.uk/mod-proposal/p444/>.

⁹ "Open letter on the Open Networks Project". See: <https://www.ofgem.gov.uk/publications/open-letter-open-networks-project>.

¹⁰ "Open letter on the Open Networks Project"; page 2.

1. Assess the effectiveness of the FSO's and Elexon's regulatory frameworks: to assess which framework is likely to be more effective at holding the organisation accountable, driving the organisation to deliver high levels of performance, etc.
2. Select the delivery body: which is informed by the comparison of the effectiveness of the respective regulatory frameworks.
3. Develop enabling amendments: to develop the amendments that are required to give effect to the MF and the associated arrangements. These are summarised in paragraphs 3.7-3.8 of the consultation (if Elexon is appointed) or in paragraph 3.33 (if the FSO is appointed).
4. Develop the rulebook: to develop the processes, rules and standards that are required for the efficient and coordinated operation of flexibility markets and which the MF will develop, maintain and monitor compliance with.
5. Codify the rulebook: to incorporate the rulebook into the BSC.

The second ('select the delivery body'), third ('develop enabling amendments') and fourth ('develop the rulebook') activities are required regardless of whether our recommendations are adopted.

The implementation activities can be grouped into two workstreams, as shown in Table 1. The workstreams can be conducted in parallel and, as such, there will be minimal impact on overall implementation timescales.

Table 1 - Market Facilitator implementation workstreams

Workstream 1 - organisation	Workstream 2 - rulebook
1. Assess the effectiveness of the FSO's and Elexon's regulatory frameworks. 2. Select the delivery body. 3. Develop enabling amendments.	4. Develop the rulebook. 5. Codify the rulebook.

We expect that developing the rulebook will require the most time, which means that the second workstream will comprise the critical path to get to the major milestone of the implementation programme. This also means that including the first activity (assess the effectiveness of the FSO's and Elexon's regulatory frameworks), which we recommend, should not increase the length of time needed to get to the major milestone of the implementation programme.

We also expect that codifying the rulebook (our second recommendation) will not have a material impact on implementation timescales. Both activities in the second workstream can be largely conducted in parallel. For example, the necessary preliminary modifications that will enable the rulebook to be incorporated into the BSC can be progressed while the rulebook is being developed. Ofgem's commitment to be more actively involved in ON should have a positive impact on the length of time needed for the second workstream and, by extension, on the critical path to the major milestone of the implementation programme.

Any potential incremental delay on the overall implemental timescales that is attributable to the second workstream should be viewed in light of the long-term benefits that will be realised because of the rulebook being codified.

The code modification process should not increase implementation risk:

In the consultation, Ofgem appears to imply that there may be greater implementation risk if Elexon is appointed as the MF delivery body, because of the code modification process.¹¹ We disagree.

Assuming it is correct that Ofgem's powers do not enable it to propose a modification to the BSC to implement the MF¹², the restriction on Ofgem's powers is not a barrier to timely implementation. There already is a template for this type of scenario, which can be followed to implement the MF. The modification to the Uniform Network Code (UNC) to implement the Central Data Services Provider (CDSP) was proposed by a gas distribution company.¹³ The Funding, Governance and Ownership programme was convened to develop changes to industry arrangements (including amendments to the UNC) to implement the CDSP. Ofgem was proactively involved in the programme.

The implementation of the CDSP was arguably more complex because of other associated changes, such as amendments to Xoserve's Articles of Association and other corporate governance arrangements. Those complexities are unlikely to apply in relation to the MF role and, as such, using the template that was used to implement the CDSP to also implement the MF mitigates any residual implementation risk. That template can also be easily applied to progress the BSC modification(s) that would be required to incorporate the rulebook into the BSC.

Answers to some consultation questions are included in the first appendix that is attached. We summarise the development of the Balancing Reserve Service in the second appendix. Please do not hesitate to contact us if you would like to discuss any aspect of this response.

Yours sincerely,

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¹¹ Paragraphs 3.7-3.8 of the consultation.

¹² Paragraph 3.7 of the consultation.

¹³ See: <https://www.gasgovernance.co.uk/0565>.

Appendix 1: answers to consultation questions

Q1. Do you agree with the proposed market facilitator design principles (in paragraphs 2.22 - 2.28)? If not, what additions or changes do you suggest?

The principles are reasonable.

Q2. Do you think some of the design principles are more important than others? If so, which should we attach greater weight to?

All design principles are important, but we think greater weight should be placed on impartiality and transparency.

Q3. How important is it for the market facilitator to be able to align transmission and distribution flexibility market arrangements? Why?

It will be critical that transmission- and distribution-level flexibility markets are sufficiently coordinated, to allow flexibility providers to access revenue streams across different markets and products in response to changing market conditions. In terms of alignment, the markets may only need to be aligned to the extent that they remove any barriers to participating across multiple markets, e.g. alignment of trading periods and appropriate metering requirements, establishing primacy rules, etc. Technical requirements (response times, response duration, etc.) can vary by product to the extent that they need to reflect the specific system needs to be met by each flexibility market/product.

Appendix 2: review of the development of the Balancing Reserve Service:

In 2022, the ESO proposed the Balancing Reserve Service¹⁴, as an alternative tool to correct energy imbalances (differences between generation and demand). The new service involved reserve volumes being procured day-ahead instead of in real-time in the Balancing Mechanism.

The ESO consulted on the proposed design for the service in 2022. The proposal favoured larger assets in various ways, including a minimum 50MW threshold and a requirement that service providers should have the capability for Mandatory Frequency Response (MFR) (which typically only larger assets can provide). Some market participants objected to the proposal because it was discriminatory – the design unnecessarily excluded smaller assets. The ESO submitted the unchanged proposal to Ofgem for approval despite objections from market participants about the discriminatory element of the proposal.

Ofgem rejected the proposal, in part because of concerns related to the barriers to entry for small flexible providers.¹⁵ Ofgem stated “...we expect the ESO to be mindful of its obligations to develop services which are non-discriminatory and to provide strong market signals that align with the goals of government, Ofgem and the ESO itself, which include opening access to markets for flexible units...”.¹⁶

The ESO revised the design of the service to reflect the initial feedback it received in response to the 2022 consultation. Some of the key changes are shown in the table below. The revised design was submitted to Ofgem in December 2023 for approval.

Table 2: Comparison of the original and revised designs of the Balancing Reserve Service

	Original design (2022)	Revised design (2023)
Minimum contract size	<ul style="list-style-type: none">• 50MW	<ul style="list-style-type: none">• 1MW
Ramp rates requirement	<ul style="list-style-type: none">• Minimum rate of 10MW per minute	<ul style="list-style-type: none">• Time to full delivery of 10 minutes
Mandatory Frequency Response capability	<ul style="list-style-type: none">• All providers must have the capability to provide MFR	<ul style="list-style-type: none">• No requirement for providers to have the capability to provide MFR
Aggregation	<ul style="list-style-type: none">• Aggregation is not permitted	<ul style="list-style-type: none">• Aggregation within Grid Supply Point groups is permitted

If the service is approved, its introduction would have been delayed by at least a year because of the need to revise the proposal and then re-consult with market participants. The delay could have been avoided had the ESO placed greater weight on the technical merit of the feedback it received in 2022. The need for the ESO to revise the proposal and then re-consult unnecessarily delayed the opening of access to markets for flexible units.

¹⁴ See: <https://www.nationalgrideso.com/industry-information/balancing-services/reserve-services/balancing-reserve>.

¹⁵ See: <https://www.ofgem.gov.uk/publications/decision-reject-amendment-terms-and-conditions-related-balancing-relation-proposed-balancing-reserve-service>.

¹⁶ Page 5 of the decision.