

Context

The ADE welcomes the opportunity to respond to Ofgem's consultation on the National Energy System Operators (NESO) licence.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side flexibility and storage, industrial energy including combined heat and power, heat networks and energy efficiency.

Summary

In deciding the policy direction of the then Future Systems Operator, now the NESO, Ofgem acknowledged that due to the very difficult nature of this role, "there is a strong case for a full review of the regulatory approaches we currently apply to the ESO under the RIIO-2 framework". We don't think that this has been taken into account in this consultation. We consider this document far too light on pushing the cultural changes and further need for transparency that will be required for this transition if NESO are going to fulfil their statutory obligations. This is a deeply disappointing development given the years of industry concern that has been relayed to both Ofgem and DESNZ. To assume that ESO, and control room in particular, will naturally reform decades of institutional thinking simply because of a change in shareholder is unfounded.

As the sole shareholder of NESO, Government must be more proactive in driving the radical cultural changes needed to make that entity deliver its statutory duties, as enumerated in the Energy Act 2023. NESO regulation must aim to improve the areas of persistent industry and regulatory concern, namely initiating a change of culture rather than just a change of name. Reforming how Electricity National Control Centre (ENCC) relates and interacts with the rest of the ESO is one such cultural change.

Cultural Change and Transparency

The following section in the consultation raises particular concern:

"Ofgem intends to use transparency obligations in the incentive framework, similar to what is currently done for NGENSO, to drive transparent behaviour from NESO for the activities where this would be appropriate. It is our view that the existing NGENSO transparency obligations related to balancing services are sufficient for NESO, and that should use its judgement on what is appropriate to be made public as part of performing the advisory duty and using the ISOP information request power."

We have laid out in numerous written responses the level of cultural change that's needed within ESO to become NESO, particularly around stakeholder engagement and transparency, which have only received passing comments on recognition and monitoring. It is made clear that current transparency obligations are considered appropriate, yet this is countered by the need for independent consultancy work. Two recent examples of this include work to establish the level of dispatch transparency being carried out by ESO following industry concerns over the

level of skip rates taking place in the balancing mechanism and what industry consider as adequate operational metering requirements.

Issues in the control room regarding digitalisation and transparency have made reformative change near impossible, as control room continue to cite their core licence obligation as balancing the grid efficiently and economically and that other obligations are peripheral. This portrays a lack of concern for their duty to treat all assets fairly and justify discriminatory actions, requirements of which are included in their licence obligations. Referring to the changes that need to be made in 'modernising' NESO to be 'promoting a new approach to system operation' as 'housekeeping' is concerning given our previous consultation responses to this proposal. We cannot simply forget the summary of the Zuhlke report, published as an Appendix of Ofgem's RIIO-2 BP 2 Draft Determinations. Not only were repeated calls made by ADE for Ofgem and ESO to hold a joint public session to discuss these results for those stakeholders perhaps not able to dedicate time to perusing regulatory appendices, ESO representatives were questioned about the report at a Parliamentary Select Committee where the only answer given was that they dispute some of the findings. For an independent audit to conclude half a billion pounds of investment raised concerns and that "Future System Operator needs are at risk" without any further public follow-up from ESO or the regulator hardly instils faith in the transparency and accountability mechanisms in place.

That said, we do not agree with the statement 'that the current framework sets suitably strong and clear requirements' for balancing services and henceforth have no intent on changing the balancing obligations for NESO Day 1.

Examples as to where these issues have been demonstrated in the past include:

- The introduction of the Local Constraint Market (LCM) was widely praised as a pragmatic approach to one of the most constrained areas of the country. However, without consultation, NGESO elected to adopt an approach to Applicable Balancing Services Volume Data (ABSVD) that, although not formally discriminatory, substantively disadvantaged independent aggregators wishing to participate in the service in comparison to suppliers. In such cases, by attempting to correct the supplier's imbalance position for balancing actions taken in response to an instruction from ESO, the supplier is inadvertently being rewarded for aggregator actions and not obliged to pass this reward to the customer. As demand turn-up services become increasingly commonplace in a world where, it is imperative that all participants are able to provide these services in an equitable way and that past market orthodoxies do not undermine the decarbonisation journey. Speaking to a wider issue, it also highlights the danger of the limited participants often involved in trials or the design phase of services where these issues are best addressed to avoid MVP lock-in as discussed above.
- As mentioned above, the Dispatch Transparency Tool to monitor BM skip rates is evidently not fit for purpose. While ESO repeatedly say that less than 1% of skips are unaccounted for, there is strong anecdotal evidence and ESO communications that indicate this is an underestimate. In the past, certain points were communicated to industry demonstrating the subjectivity of dispatch decision-making. In particular:
 - o When the control room is busy and operators take an out-of merit action because of its volume, this is not considered a 'true skip', rather they look to what caused the business for example, constraint, frequency. In the tool, therefore, the action is attributed to operational conditions not as a result of the limitations of manual dispatch.
 - o When making decisions on whether to dispatch 1x20MW unit or 20x1MW units, control room takes into account discrepancies in unit forecasts. Even though the

probability of average discrepancy may be similar, it is easier for them to phone the 1x20MW in case of a fault than 5x1MW units.

- Since engineers can more readily recall the parameters of large volume assets rather than the duration of many small batteries, this can impact their decision making.
- If engineers believe they may need fast acting units such as batteries at a later time they may opt not to accept their bids and offers in order to avoid them being unavailable later. However, if those assets are not later needed they are left unutilised.
- In an effort to prioritise pace, NGESO opted for minimum viable products (MVPs) as opposed to fully rounded designs in their approach to ancillary service reform, launching their first reformed Frequency Response product, Dynamic Containment (DC), at the end of 2020. The requirement of 60-minute nominated baselines as the default parameter for new products resulted in many non-battery assets that could participate in the extremely fast responding Dynamic Frequency Response services being excluded. Although the alternative approach using derived data, as proposed by the ADE and its members, was well received by the ESO, the process to get this change in the Service terms that would enable this proposal to be advanced has taken over three years. Delays such as this undermine the objectives of market reform under RII0-2 to remove barriers, increase participation and create competitive markets. The longer certain types of aggregation are precluded from the market, the longer it will take to fulfil these objectives, including getting more low carbon assets on the system.
- Upon the entry of independent aggregators into the BM in 2019, NGESO introduced new operational metering requirements for small (sub-100MW) participants without industry consultation or regard to the regulatory metering requirements of individual assets. These mandate that operational metering is reported at 1 second intervals with 1% accuracy, as well as the monitoring of both real and reactive power. ESO has now launched an incentive to give 300MW of small-scale flexible assets access to the BM with somewhat relaxed requirements. We look forward to seeing the outcomes of this, as these standards at present represent a disproportionate barrier to participation for many flexible assets and need to be implemented on a larger scale.

Accountability

We look forward to seeing the financial framework that will be sent out in the December consultation. In our previous response we made clear that we fear reputational damage has not always mitigated the risks that Ofgem points to, so making sure that there are the correct accountability measures in place will be vital. In NESO becoming not-for-profit, Ofgem lose their most powerful regulatory tool-finance, placing lots of confidence in the level of change that will flow simply from being a public body with statutory obligations. We place particular emphasis on the point around NESO's IT systems as the IT transformation that NESO will have to undertake is unlike anything in the organisation's history and needs to be adequately regulated for, including accounting for long-term spending projects.

Cross-cutting themes

At the beginning of the year, we responded to Ofgem's consultation to decide which organisation would be best suited to become Market Facilitator. Where ESO would be the obvious choice, industry decided that Elexon needed to be considered for this role. This is not only an outcome of Elexon's reputation for excellence across multiple roles in the energy market

and proven track record in cross stakeholder project delivery, but a deep mistrust of the ESO for the above reasons, despite being a clear choice for the role.

With so much happening in the industry, such as the continuous progress of the RIIO-2 price controls, the future establishment of the Market Facilitator, ESOs transition to the NESO and of course the Review of Electricity Market Arrangements (REMA), the importance of cross-departmental communication is vital. From our communication across these teams over the past few months, it is not implied that this is the case. The concerns above have been raised in numerous responses and discussions, yet the impacts that each of them will have on one another does not seem to have been taken into consideration. We hope that as ESO transition into the role laid out in the consultation, the impacts of the decisions made across the industry are recognised.

Under REMA specifically, many of the reform options on the table are not simply a symptom of a changing system but a symptom of poor system governance. The appeal of options such as zonal pricing and central dispatch are closely linked with a deep suspicion with industry that ESO is incapable of producing the needed changes on an incremental basis and therefore wholesale reform is needed. As a public body, upon which the Government will depend for expert advice, the continued lack of cultural transformation in the day-to-day running of ESO threatens any market changes decided upon through REMA.

Government cannot continue to ignore the risks ESO culture pose for REMA.

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