

17 April 2023

By email to :

Fiona Campbell & flexibility@ofgem.gov.uk

Please reply to Sustainability First associate :
judith.ward@sustainabilityfirst.org.uk

Dear Fiona and Ofgem Flexibility colleagues

Future of Local Energy Institutions and Governance – Ofgem Consultation

Sustainability First is a think-tank and charity with a focus on social, environmental and economic issues in essential services and in particular energy and water. We have significant experience of the RII02 price control process through involvement in the Ofgem Challenge Group, Consumer Engagement Groups and Ofgem stakeholder working groups. We have also carried out significant work on how regulatory models need to adapt to meet the challenges ahead on net-zero and fairness¹.

Thank-you for the opportunity to contribute to this consultation on local energy institutions and governance. Sustainability First submitted evidence to the earlier Ofgem Call for Input². In that response we argued that any institutional arrangements aimed at addressing net zero must look more widely than just at energy and urged Ofgem to work with government to consider the wider reforms needed to deliver on decarbonisation of heat and transport. This remains a challenge.

Within the confines of Ofgem's remit, we welcome that Ofgem in its case for change has now more clearly recognized the significant local-level challenges posed by a lack of effective regional and cross-vector planning, plus the need for greater market standardisation and coordination. We note Ofgem's continued focus on three key activities to address these challenges : regional system planning to enable whole-system strategic planning at sub-national level; market facilitation; and system operation. We note that Ofgem expect their proposals to be adaptable to future change. And we welcome that Ofgem has stepped back from full legal separation of the DSO from the local network where we had judged Ofgem thinking to be premature - in particular that the benefits-case had not been made.

We have sought to provide answers to some of the detailed consultation questions in an annex, but we also wish to make some more fundamental points about the areas we see as important for Ofgem to address in considering next steps on local-level energy governance.

¹ Sustainability First. Fair for the Future project papers 2019-2021.
<https://www.sustainabilityfirst.org.uk/publications-public-purpose>

² https://www.sustainabilityfirst.org.uk/images/Sustainability_First_-_Local_Energy_Institutions_and_Governance_-_Ofgem_Call_for_Input_-_6_June_2022_FINAL.pdf

A successful energy transition at the devolved, regional, local and community level is basic to meeting our wider net-zero goals for GB. From the standpoint of the consultation as drafted, this will therefore require Ofgem to :

- **Address the practical realities of place-based approaches to net-zero delivery in a far more concerted way.** This requires far clearer recognition by Ofgem of the role and capabilities of the devolved governments, regional and local government and communities in energy-transition delivery. Ofgem’s proposals must build on how regional and local actors already interface with their local energy systems, including existing relationships with regional electricity and gas networks. Ofgem should ensure its local governance proposals promote what already works well as well as addressing the very many practical problems experienced by local actors. Ofgem’s clear priority should be to find ways to better support and enable place-based actors to carry out their leading-role in net-zero delivery and their efforts to shape a just and inclusive transition.
- **Reflect far more broadly on what good looks like in terms of place-based energy outcomes – and what, as economic regulator, Ofgem must do to facilitate those outcomes.** As described in the consultation, Ofgem’s thinking on local energy governance appears very largely shaped by an over-arching assumption that local governance will best be facilitated through (1) ensuring safeguards against potential DNO / DSO conflicts of interest (perceived, actual) and (2) by greater network competition to drive efficiency (internal, external competition). Ofgem urgently needs to re-think this extremely narrow framing. It must ask itself whether a focus on DNO/DSO conflicts and ever-more competition will really be the optimal way for Ofgem to enable better place-based outcomes for net-zero energy. With a clear focus on a decarbonized power system by 2035, and a fully decarbonized economy by 2050 or earlier, Ofgem should consider how best to promote more coordinated and collaborative approaches to energy system planning that can also be locally-led. **Crucially, this goes well beyond the task of facilitating and promoting local flexibility.** This includes better local outcomes from the standpoint of all kinds of energy end-user – whether customer, community or citizen. For example, as well as local cross-vector planning Ofgem must also enable the energy networks to drive local energy demand reduction (be that through thermal insulation schemes for buildings and homes or through improved management of electrical losses). Sustainability First researched both these areas extensively in the context of the ED2 price controls³. A key institutional question for Ofgem is how far it will need to reform its own organisation and governance structures in order for it to become more regionally-oriented in its approaches to energy system regulation.
- **Given the importance of place-based and devolution agendas, Ofgem must provide far more evidence as to why the Future System Operator is best placed to take-on the roles of either regional energy system planner or market facilitator.** Ofgem’s main rationale for the FSO to take on each of these roles seems driven, as noted above, by its overarching pre-occupation with network conflicts of interest (perceived, actual) and promotion of competition. DNOs, especially

³ Energy Efficiency : what is the DNO role in ED2? Note to Ofgem. March 2021
https://www.sustainabilityfirst.org.uk/images/publications/consultations/RIIO-ED2_SSM_-_Note_to_Ofgem_on_DNO_Energy_Efficiency.pdf

DNO Losses Strategies. A commentary by Sustainability First. February 2022
https://www.sustainabilityfirst.org.uk/images/Sustainability_First_-_Commentary_-_DNO_ED2_LOSSES_STRATEGIES_-_final090222.pdf

through the ED2 business planning and DFES process (Distribution Future Energy Scenarios) and also through comprehensive stakeholder engagement, have made marked progress in developing their locally-oriented expertise, local relationships and better approaches to local problem-solving including some small steps on cross-vector (eg local connections planning) as well as greater transparency. Through the Open Networks programme, DNOs have collaborated for an extended period on the detail and complexity of facilitating local electricity markets (albeit there is still a way to go to on full flexibility-market standardization and coordination). Open Networks has significant ESO input. Given progress at the DNO-level - plus the importance of maintaining strong regional and local relationships, it seems unconvincing to turn over these roles to the FSO. Ofgem must justify far more clearly - and against its own assessment criteria⁴ - why the regional system planner and market facilitator roles should transfer to the FSO. For example :

- How far this proposed top-down institutional arrangement – with the FSO taking on the regional planner and market facilitation roles – sits within the broad context of place-based agendas and decision-making, including from a socio-economic and political standpoint.
- The evidence Ofgem has that the ESO today - or the FSO in future – can bring the necessary leadership, expertise or capability in the timescales needed (regional energy planning, including cross-vector; local energy market facilitation) for delivery of a resilient and fully decarbonised power system in 2035.
- How, in transferring regional planning and market facilitator roles to the FSO, a needless hiatus can be averted, including adversely impacting current DNO commitments to making local governance work well over the next five years - commitments only recently endorsed by Ofgem via the ED2 process.
- How far Ofgem has considered whether the regional system planner and market facilitation roles could just as well be handled by improved DNO- and GDN-led coordination, perhaps driven by new licence obligations. And against Ofgem’s own criteria, the case considered for alternative local institutional and governance arrangements ?
- If ultimately Ofgem and DESNZ decide that the FSO has a role to play in this space then important questions follow as to whether that should be a narrow co-ordination and facilitation role (which may have some logic) – or whether, as the consultation seems to imply, Ofgem will look to the FSO to actually take over these functions.
- **How Ofgem sees the ongoing role for regional stakeholder engagement and accountability in a place-based energy system being led by the FSO instead of by DNOs and GDNS – and how this sits with current stakeholder and consumer engagement arrangements for the distribution networks. For example, at an operational level DNOs will still need to engage closely not only**

⁴ Accountability, Credibility, Competence, Coordination, Simplicity, Dynamic

with local authorities but also with very many more ‘bottom-up’ demand-side stakeholders who seek to connect and to provide flexibility services. Duplicating this engagement cannot make sense.

To conclude, we see it as important for Ofgem to reflect more broadly on how its vision and consultation proposals for local energy institutions and governance can best serve the evolving place-led interests of energy consumers, end-users, citizens and communities. Avoiding conflicts and promoting economic efficiency - a main focus of this consultation – have a part to play. But a much bigger challenge for Ofgem as economic regulator is how best to support the critical role of local actors in developing a future de-carbonised energy system – whether at the level of devolved government or as a local community. We would like to see Ofgem reflect further on whether their present proposals risk being unduly top-down – whether for regional energy planning or for improved technical coordination of area-level energy markets. The key is surely to ensure that those best-equipped to deliver on place-led solutions are in a position to do so. For DSOs, DNOs and GDNs this includes enabling and clearly incentivising their many critical relationships with local stakeholders to continue to develop and flourish. Last, in developing regulatory approaches to local governance, especially given that many place-based actors are democratically elected, Ofgem should clarify how far it expects the regulated networks and system operator to actively facilitate wider regional- or local-goals for economic and social development linked to net-zero.

Yours sincerely

Judith Ward
Associate
Sustainability First
Judith.ward@sustainabilityfirst.org.uk

CC Sustainability First:
Maxine Frerk. Associate
Zoe Mcleod. Policy Director.

**Annex – Local Energy Institutions and Governance
Answers to Ofgem Questions**

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?

We agree that it is necessary to improve regional and local-level coordination for whole-system energy planning at the sub-national level.

However, in seeking place-based outcomes, the case has not been made in the consultation for this to be delivered via the FSO. DNOs, especially through the ED2 business planning and DFES process (Distribution Future Energy Scenarios) and also through their extensive stakeholder engagement, have made significant progress in developing locally-oriented expertise, local relationships and better approaches to local problem-solving (including some small steps on cross-vector (eg on local connections) as well as greater transparency. This is true to a degree for the GDNs also. The issue is how to place responsibility through existing DNO and GDN roles and licences for better coordination on energy planning at a sub-national level – and how to integrate this with system planning roles beyond the energy sector to include housing and transport.

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

See answer to Q1

Ofgem needs to reflect far more broadly on what good looks like in terms of place-based energy outcomes – and what, as economic regulator, Ofgem must do to facilitate those outcomes. As described in the consultation, Ofgem’s thinking on local energy governance appears very largely shaped by an over-arching assumption that local governance will best be facilitated through (1) ensuring safeguards against potential DNO / DSO conflicts of interest (perceived, actual) and (2) by greater network competition to drive efficiency (internal, external competition). Ofgem urgently needs to re-think this extremely narrow framing. It must ask itself whether a focus on DNO/DSO conflicts and ever-more competition will really be the optimal way for Ofgem to enable better place-based outcomes for net-zero energy. With a clear focus on a decarbonized power system by 2035, and a fully decarbonized economy by 2050 or earlier, Ofgem should consider how best to promote more coordinated and collaborative approaches to energy system planning that can also be locally-led. This goes well beyond the task of facilitating and promoting local flexibility. This includes better local outcomes from the standpoint of all kinds of energy end-user – whether customer, community or citizen. For example, as well as local cross-vector planning Ofgem must also enable the energy networks to drive local energy demand reduction (be that through thermal insulation schemes for buildings and homes or through improved management of electrical losses). Sustainability First researched both these areas extensively in the context of the ED2 price controls⁵.

⁵ Energy Efficiency : what is the DNO role in ED2? Note to Ofgem. March 2021
https://www.sustainabilityfirst.org.uk/images/publications/consultations/RIIO-ED2_SSM_-_Note_to_Ofgem_on_DNO_Energy_Efficiency.pdf

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

See answer to Q1.

The consultation also needs to take full account of the statutory remit of the devolved governments in Scotland and Wales.

A key institutional question for Ofgem is how far it will need to reform its own organisation and governance structures in order for it to become more regionally-oriented in its approaches to energy system regulation.

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

We are unconvinced of the Ofgem case for the FSO to take on the regional planner role against its own governance criteria (Accountability, Credibility, Competence, Coordination, Simplicity, Dynamic)

We are not aware of what evidence Ofgem has considered for the ESO today - or the FSO in future – in terms of required leadership, expertise or capability in the timescales needed for regional energy planning, including cross-vector, to ensure delivery of a resilient and fully decarbonized power system in 2035 and to support decarbonization of the wider economy.

Against the Ofgem criteria, we would like to see the case also fully considered for DNOs / GDNs or regional government to take on this new regional energy system planner role

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 that there is scope to considerably improve on current efforts on market standardisation and value stacking through improved coordination arrangements for market facilitation. However we do not necessarily agree that this must mean transferring the role to a single, neutral expert entity.

Through the ENA Open Networks programme, DNOs have collaborated for an extended period on the detail and complexity of facilitating local electricity markets (albeit there is still a way to go on full flexibility-market standardization and coordination). Open Networks already has the benefit of significant ESO input. Open Networks also works closely with market participants.

There may be a case for a stronger remit – and therefore stronger leadership through the Open Networks work programme – and also greater resource commitment from DNOs. At the same time, given progress made through Open Networks it seems unconvincing to turn-over the market facilitation role to the FSO. This would not short-circuit or obviate the need for extended consultation and discussion, including with market participants.

DNO Losses Strategies. A commentary by Sustainability First. February 2022
https://www.sustainabilityfirst.org.uk/images/Sustainability_First_-_Commentary_-_DNO_ED2_LOSSES_STRATEGIES_-_final090222.pdf

Ofgem must justify far more clearly - and against its own assessment criteria (Accountability, Credibility, Competence, Coordination, Simplicity, Dynamic) - why transferring the market facilitator role to the FSO would substantially improve on present Open Networks arrangements.

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

See Question 5

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

-

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

See Question 5

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?

See Question 5. The case for Open Networks and DNOs to retain responsibility for this role needs to be actively explored against Ofgem's own assessment criteria (Accountability, Credibility, Competence, Coordination, Simplicity, Dynamic). Ofgem could use its existing regulatory toolkit – including the recently introduced DSO incentive – to ensure more emphasis on collaboration and standardization.

If Ofgem still considers that there is a role for the FSO then there is a question about the scope of that role and whether it is essentially to drive standardization and coordination rather than to take on that role unilaterally. It does not seem plausible that local flexibility can be effectively developed without a strong role for DNOs articulating their requirements.

We do not see a case for Ofgem (rather than the FSO) to take on this role.

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

Yes

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

We would agree that there are likely to be significant benefits associated with better coordination and delivery of energy system planning at the sub-national level and also in ensuring that flexibility markets which are more accessible both nationally and locally.

However, we believe that Ofgem must also take account of the resource constraints of very many local actors on whom regional and local net-zero delivery will depend. Unless local government

resource constraints are appropriately factored into Ofgem institutional approaches, it may be hard to realise the benefits, including in the timescales envisaged.

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

The counter-factual implementation of existing policies, including those required within RII0-ED2, but no additional independent regional system planning activities and no independent market facilitator does not seem appropriate. Subject to developments in government policy, there could well be other improvements in regional system planning and in market facilitation wholly independent of these Ofgem reforms.

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.

-

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.

On the cost-side, the government impact assessment for the FSO will need re-visiting.

The FSO is likely to have a considerable learning curve about electricity and gas distribution. Not least, electricity distribution is a far more technically complex business than electricity transmission.

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.

In transferring both the system planner and market facilitator roles to the FSO there could well be new costs relating to (1) friction arising from added layers of coordination plus (2) a delivery hiatus as a result of DNO inertia and demotivation over the coming 5 year period.