

Ofgem's Consultation on Future of Local Energy Institutions and Governance

Northern Powergrid Customer Engagement Group's response

Introduction

We welcome the opportunity to respond to this consultation which addresses issues that are of real importance to all members of our society, whether or not they are current electricity customers.

As an independent Customer Engagement Group (CEG) our role is principally to scrutinise the work of Northern Powergrid to ensure that it is conducted in the best interests of its customers and stakeholders¹. But in view of the importance of the issues raised in this consultation for this same group of people we want to offer our views to Ofgem for consideration in its policy development. While the views in this document are our views as a CEG and do not represent the collective views of Northern Powergrid's customers and stakeholders, we have sought input from some important local stakeholders such as Local and Combined Authorities to help inform this response.

Our draft response was shared with the Northern Gas Networks (NGN) CEG to seek their views and input. We felt that this was in the spirit of the consultation exercise as we share many of the same stakeholders and gas distribution companies will need to be key partners in/members of the Regional System Planners responsible for their geographic footprint. The NGN CEG supports the overarching points made below and the responses to questions 1-4 and 12-15. They have not reviewed questions regarding flexibility markets that do not relate directly to gas distribution.

The CEG supports the key components of the reform package proposed in this consultation but has significant reservations about some of the detailed implementation proposals.

Overarching Points

The issues raised in this consultation are wide ranging and could potentially have profound consequences for how consumers' needs are met in future, and how the substantial benefits available from decentralisation of generation and digitalisation of the electrical system are realised and shared. We would like to make three overarching points before addressing Ofgem's specific consultation questions.

¹ CEG Terms of Reference can be found here: <https://ceg.northernpowergrid.com/?tax-download-type%5B0%5D=5&keywords#documents>

Consideration of the broader functional context: The effective discharge of the functions identified in the consultation needs to be considered within the wider context of the broader whole energy systems and planning functions. Importantly, this includes spatial and broader regional planning which is so inextricably linked with energy market needs and opportunities. A critical consideration for any proposed change is whether or not it will facilitate effective coordination between the energy system and local/regional spatial planning.

Citizens' engagement and protecting customers' interests: Timely achievement of net zero level will require a high level of 'buy-in' from citizens across the country since their individual choices will combine to determine the pace at which decarbonisation occurs. To facilitate such 'buy in' it is important that the new arrangements are seen to be equitable, attuned to local needs and priorities, and agile enough to respond appropriately as those needs and priorities change over time. These considerations have important implications for the design and governance of the institutions: the arrangements need to be transparent, open to public scrutiny, and - crucially - accountable locally as well as nationally.

Timing of institutional change: We strongly agree with the points made about the importance of speed of change made in the Foreword to the consultation document. However, we would respectfully point out that it is time to effective implementation of decisions which is key, rather than simply time to decision. This has an important bearing on the choice of detailed implementation options within the reform package.

Responses to specific questions

Question 1: Do you agree with our proposal to introduce Regional System Planners?

Yes, we fully support the need to introduce new Regional System Planners ("RSP(s)") with accountability for regional energy system planning. However, we believe that more consideration needs to be given to the proposed governance of these bodies to ensure that they are, and are seen to be, sufficiently accountable to their local stakeholders and communities. Failure to do this could significantly impair their future effectiveness. See answer to Q2 below.

Question 2: What are your views on the detailed design choice considerations described?

We agree that accountability is a key factor to be considered. In order to ensure that the RSP meets the national energy system needs we recognise the wisdom of proposing that it should be a regulated entity accountable to Ofgem. However, in order for it to be effective in contributing to alignment between energy system and spatial planning and for it have local legitimacy, it also needs to have local

accountability formally built into its governance structure. This is missing from the current Ofgem proposal, and we see that as a major shortcoming.

The RSPs, to be effective, will need to balance the priorities of national energy system planning with those of local spatial planning. This requires them to be accountable both locally and nationally and strongly suggests that governance arrangements which formally include local authorities as well as Ofgem (through its regulation) will be most effective.

The consultation asks for examples of partnership arrangements and best practice coordination structures. There are many different such arrangements in existence in different spheres, but a frequently used approach is to establish a Board with broad representation from stakeholders (in this case FSO, the relevant spatial planning authorities, network companies, energy market players, etc) together with a governance document that stipulates transparency and accountability locally as well as nationally. This would meet the requirement set out in para 3.20 of the consultation document, but not addressed in the current proposal, to ensure that the regional context is meaningfully reflected in the process.

Beyond the electricity sector in other regulated markets, the Environment Agency, Yorkshire Water and local government with wider partners joined together to produce the Connected by Water Action Plan.² This collaborative approach to manage flood risk is a step forward and demonstrates that it is possible to create such institutions where they do not currently exist beyond the well developed and strong stakeholder relationships that can be evidenced in the North East and Yorkshire.

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

We do not have a firm proposal for the appropriate regional boundaries. There is no perfect answer to this question. The boundaries across the various systems (electricity, gas, district heating, transport, local authority, etc) are not coterminous. In addition, the most effective scale for planning varies according to both the issue and the specific place. So, compromise will be needed in reaching workable solutions across the country.

There are some considerations, however, that can help to guide decision making:

- The boundaries of the different energy systems are not coterminous so do not offer any simple neat solutions. This suggests that using local government boundaries, which are coterminous with spatial planning boundaries, would be sensible.
- Since national coordination is important, it would be unwieldy (and hence unwise) to have too many RSPs, so each RSP will of necessity have to plan over a wider area than a single local authority. But local authorities are used

² <https://connectedbywater.co.uk/files/action-plan.pdf>

to cooperation of this kind, and that in turn gives an indication of the type of governance that might be most effective.

- Effective planning of many issues will require detailed work at a very local level, the RSP will need to coordinate its work with a number of sub-regional organisations. Working through local authority structures will facilitate such an approach, and so again favours using local government boundaries for RSPs.
- The Combined Authorities which have been created in many areas of England are one institution that could be responsible for the RSP function, or groups of upper tier authorities and combined authorities mapped to DNO licence areas would leave fourteen. The sub national transport bodies including Transport for the North at the level of the mega region demonstrate that if local government bodies need to collaborate at geographies wider than their own areas this can be done both practically and efficiently, whilst recognising the need for decision making to take place at the lowest appropriate level.
- There would need to be adequate resourcing of the RSP to enable Combined Authorities to take on additional responsibilities, whether through an Ofgem licence obligation or central government funding (see comments below).

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 not convinced that the FSO has the appropriate characteristics to deliver this role, which entails balancing the needs of the energy and spatial planning systems.

FSO is a new national body still establishing itself. Quite apart from not having the structure or governance arrangements necessary for this role, it already has a substantial challenge in establishing itself to discharge its current and other new roles effectively. Adding the regional role (with its essential local attributes) would be a very substantial extension of its work and so would introduce significant risks to the effective delivery of both its current and new roles. These risks would be further increased if the FSO were also given the market facilitator role discussed elsewhere in the consultation. We do not think that the consultation proposals give sufficient weight to these risks.

We do not believe that the FSO as currently established would be able to demonstrate sufficient regional orientation to be credible locally, even with regional branches. The lack of clear and formal local accountability would continue to be an insuperable barrier, even if FSO were to develop the skills necessary for effective local engagement (which it has not demonstrated to date).

Having a body that follows the approach set out in our answers to questions 2&3 and which is regulated by Ofgem is the arrangement which is most likely to achieve an appropriate balance of the needs of spatial and energy system planning and which would also enjoy the confidence of its wide range of stakeholders.

As discussed, Transport for the North is an institution made up of its constituent member authorities. It was originally non-statutory, and was then given statutory status, and a similar pathway would be possible for a new set of institutions to meet the requirements set out in the consultation.

If Ofgem is not convinced of the importance of having a local government led body as RSP, then we suggest it should require the network companies (electricity and gas working together) to discharge this role for their networks but with a formal licensed obligation to involve local government in the oversight of this role and to continue to work very closely with all relevant stakeholders. Local government involvement in the oversight of this work (eg through membership of a supervisory board) would serve to strengthen the links between energy system and spatial planning. The FSO could then play a role in convening the RSPs nationally. This approach would build on the work that DNOs have been undertaking in developing their Distribution Future Energy Scenarios and more specifically the collaborative approach that Northern Powergrid and Northern Gas Networks are taking to Local Area Energy Planning which has already led to the development of improved local relationships.

Whatever approach Ofgem is minded to adopt, we urge it to consider carefully the resource required to make the regional system planning successful (including its effective integration with regional and local spatial planning) and to make sure it is appropriately funded.

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?

In order to achieve maximum market efficiency, it is important to define markets appropriately, and avoid creating artificial boundaries. For electricity this includes the wholesale market, as this provides the context within which the value of flexibility is determined. The current proposal does not address this part of the market and so may not deliver the full potential value of flexibility. We think Ofgem should reconsider this.

We agree that there should be open and transparent markets that are unbiased by the commercial interests of the buyer(s), and that the governance arrangements must ensure there are standardised, fair, and transparent rules and processes for procuring flexibility services to enable service providers to participate easily in these markets.

We also agree that current work to align flexibility markets is not proceeding fast enough, and so a significant change is needed.

Establishing a neutral expert entity to take on a central market facilitation role is therefore logical.

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

No specific points.

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

No specific points.

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

In terms of the detailed design choice of FSO as market facilitator we are concerned that Ofgem's proposal, while recognising the conflict inherent in FSO's role as a buyer in the market, does not address it.

The document (at para 4.25) recognises the desirability of having a neutral third party as facilitator, and the possibility of using an independent market platform. Our understanding is that such platforms do exist and so the necessary capacity building may not be as extensive as implied in the document. Our understanding is that there are already companies that operate facilitating market trading between buyers and sellers of energy so, with suitable oversight, they could take on the proposed role.

We recognise that establishing suitable regulatory oversight is an important issue but are not convinced that it is an insuperable challenge. We therefore believe that this option deserves further exploration before a suboptimal solution (FSO with its conflict of interest) is adopted.

One such option would be for Ofgem to add a condition to the FSO and network companies' licences requiring them only to trade through an Ofgem approved facilitator, and then for Ofgem to require the facilitator to adopt whatever standards and rules Ofgem deems appropriate in order to gain approval (in the same way as the Energy Ombudsman is approved by Ofgem).

Such an approach would give Ofgem regulatory control over the market platform without the need for a new licence to be established. For example, Ofgem could require that the market facilitator doesn't trade on its own behalf, i.e. it neither buys nor sells flex itself, and that all data on the market and trades through it is openly published.

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 answer to question 8.

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

We agree that DNOs should retain responsibility for real time operations but believe that the arrangements for ensuring responsiveness to other market participants and stakeholders should be augmented by increased requirements for transparency and accountability. We do not believe that there are sufficiently compelling arguments for separation of this function from that of asset stewardship to overcome the obvious risks of distraction and disruption of the critical function of reliable and resilient supply.

We agree that effective coordination with other actors is central to delivering optimum real time operations. In view of the crucial role that RSPs are to have in the new system, DNOs should have a licence requirement to cooperate fully with the new RSPs and there should be financial consequences (incentives and fines) associated with the quality of delivery of this activity. Please also see our response to question 27 in Ofgem's consultation on ED2 Draft Determinations.

As with all arrangements in such a regulated market, the responsibilities for real time operations should be reviewed from time to time to check that they are working efficiently and effectively and remain fit for purpose. This is particularly true when markets are changing so fundamentally and rapidly.

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

We have not considered this in any detail, but at a high level the approach looks sound.

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

At a high level the approach looks sound, but it is important not to overlook benefits outside the energy system. Para A1.13 does not explicitly include the benefit of improved coordination between energy system and spatial planning. We are concerned that the existing lost synergies between spatial and energy system planning should be fully taken into consideration in any analysis. This may well yield very substantial benefits to communities across the country in terms of speeding up necessary decarbonisation and infrastructure investments.

Q13. How should we attribute these benefits between the governance changes in the proposed option, and other changes required to achieve the benefits? We particularly welcome analysis from bodies that have undertaken an

assessment of benefits, specifically how those benefits might be attributed to different policy reforms that are required to achieve those benefits.

No comment.

Q14. What additional costs might arise from our governance proposals? We welcome views both on the activities that may arise and cause additional costs to be incurred, as well as the best way to estimate the size of the costs associated with those activities.

No comment.

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.

We do not have information on any specific costs, but we note that it is much easier to identify the costs of establishing new interacting organisations than it is to identify and estimate the benefits of their activities. In particular we are concerned that the existing lost synergies between spatial and energy system planning may not be fully taken into consideration in any analysis. As stated earlier, sufficient resources must be dedicated to ensuring good governance and decision making.