Energy UK response to the Ofgem Call for Input on the Future of Local Energy Institutions and Governance

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About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

Executive Summary

Energy UK welcomes the opportunity to respond to this Call for Input, and are pleased with the importance Ofgem is placing on the reform of local energy institutions. Given the long-term scope of this Call for Input, it is an opportunity for ambitious recommendations, with a whole-systems lens. This needs to include the role of local government, and where it fits into the holistic sub-national energy strategy.

The Future Worlds work made an important contribution to identifying future network requirements and services, however, Energy UK members are disappointed that more progress has not been made in terms of separation of roles and development of DSO functions. This Call for Input is, therefore, an ideal opportunity for Ofgem to set out clear policy steps and framework to revisit these and other requirements, as well as providing a view on enduring governance arrangements.

If you have any questions regarding this response, please get in touch via the details below.

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Responses to Questions

1. Are the three-energy system functions we outline (energy system planning, market facilitation of flexible resources and real time operation of local energy networks) the ones we should be focusing on to address the energy system changes we outline?

Yes, we broadly agree with the three system functions identified. We particularly welcome the focus on cross-cutting digitalisation with open data standards as a fundamental enabler for the DSO transition. Any assessment of an institution's ability to carry out a particular role must include their capabilities and progression plan with regard to digitalisation. We strongly endorse the recommendations of the Energy Digitalisation Taskforce report on Delivering a Digitalised Energy System[1] and would like to see these enshrined in any recommendations that result from this Call for Input.

We also wish to highlight the importance of monitoring as part of real-time network operation. High visibility and comprehensive market information will be key to efficient and coordination network operation.

Finally, we would welcome clarity on which system function will have responsibility for connections, as this would seem to fit across planning and market facilitation.

2. Do you agree with the criteria we have set out for assessing the effectiveness of institutional and governance arrangements?

Yes, we agree with the assessment criteria listed. We would additionally like to see transparency included as an assessment criterion. In order to achieve the largest system and consumer benefits from the future governance framework, it will be vital that communication is transparent, regular and bi-directional.

We also propose including consistency as an assessment criterion. Any future governance framework must not create regional disparities in terms of cost methodologies, conditions and processes for connections, ability to access low-carbon technology such as EVs and heat pumps, or ability to meet net zero. We recognise that regional differences have lead local authorities adopting different approaches to the net zero transition, however, we are keen to mitigate any 'postcode lottery' that this may create.

We agree with the findings set out in the Citizens Advice 'Look before you LAEP[2]' report, and highlight the importance of a clear, consistent, coordinated local planning. Any review of planning must consider not only the connection of new assets, but also the retrofit market, and the large rollout of heat pumps and EV chargers expected over the coming years. Registration of these assets must be simple and digitalised, to ensure they are visible and their impact on the system is understood.

3. Do you agree with our assessment of how far the current institutional arrangements are, or are not, well suited to deliver the three key energy system functions?

We largely agree with the assessment of current arrangements. With regards to any potential conflicts of interest, this issue may hamper the investment case for flexible assets in GB, and in doing so damage our ability to transition to net zero in the most cost-effective manner. This risk is recognised in the Open Networks work on Conflicts of Interest and Unintended Consequences[3], and in Ofgem's own reviews of separation of Transmission Owner and Electricity System Operator.

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[1] Delivering a Digitalised Energy System, 2021, https://es.catapult.org.uk/report/delivering-a-digitalised-energy-system/

[2] Look before you LAEP, May 2021, https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Local%20Energy%20Report.pdf

[3] Conflicts of Interest and Unintended Consequences, Q2 2022, https://www.energynetworks.org/creating-tomorrows-networks/open-networks/distribution-system-operation-transition

We would also like to flag the complexity of current arrangements, which may create a barrier to entry for some participants in local flexibility markets. We welcome the ENA Open Networks Project's work on standardization and coordination. However, we are concerned that without Ofgem intervention to ensure consistency, it may result in DNOs each creating their own market platforms with different rules for market entry and operation, possibly hampering the investment case for flexible assets. Any review of flexibility market arrangements must feed into standards for domestic installations, for example the BSI PAS 1878 and 1879 standards for smart appliances.

4. Overall, what do you consider the biggest blocker to the realisation of effective energy system planning and operation at sub-national level?

We have identified a number of blockers to the realisation of an effective sub-national energy system fit for net zero:

- A lack of progress by the DNOs towards clearly separated DSO functions, and a lack of intervention by Ofgem. The direction of travel has been clear, particularly since the Open Networks Future Worlds work in 2018. However, since then, progress has been slow and engagement through the Open Networks project with those outside the regulated monopolies needs to be improved. In addition, there is little in the ED2 Business Plans (with the exception of UKPN) that gives confidence that progress towards separation of functions is high on the Networks' agendas.
- Any potential conflicts of interest may block investment in flexible assets, as investors may lack confidence their assets will be utilised effectively and access sufficient revenues. In theory, the Open Networks Project has done work to ensure that network reinforcement and flexibility options are valued fairly. However, the lack of communication around projects like CLASS has not improved the necessary dialogue between DNOs and customers.
- This highlights a clear gap in accountability around the DSO transition. The Networks, the ESO, Ofgem and BEIS must be transparent in their responsibility for the outcomes of the DSO transition. It is vital that this accountability is clarified in order to achieve positive outcomes for consumers and the system as a whole.
- We also wish to highlight the lack of coordination in planning between different bodies, particularly gas, electricity and heat networks and local authorities. These bodies have conflicting priorities and different mandates, and the lack of a holistic strategy may limit their ability to deliver. This leads to issues getting assets connected, which may delay investment in GB and hamper the net zero transition.

5. Do you agree with the opportunities of change we outline and the potential benefits they may create?

Yes, we agree that reform of the current delegation of responsibility provides an opportunity for a more transparent, coordinated and efficient system that is more attractive to investors.

6. Are there additional opportunities for change and benefits that we have not set out?

We believe that Ofgem has the opportunity to reflect on how to best coordinate across all energy vectors in order to deliver the best outcomes for the system and consumers. This will likely require engagement and support from Government to fully assess opportunities for and benefits of change in order to obtain the optimal sub-national energy system.

7. We set out a number of risks associated with change. Do you agree with these risks and the potential costs they create? Are there additional risks of change and costs that have not been set out?

We accept that creating new, licensed entities will be complicated, however, this is no reason not to proceed. We would like to highlight that there could have been an expectation that when DNOs took on DSO activities, there would be an appropriate degree of separation. If the DNOs had carried this

out, legal separation would be simple, and there would be no issues with duplication of activities or gaps in accountability.

Therefore, we also agree that any reform is likely to be disruptive and costly. Consequently, any options for institutional and governance reform should be subject to a robust cost-benefit analysis, including impacts on local government institutions.

8. For each model, we have set out the key assumptions which need to be true for the model to offer the right solution. Which of these assumptions do you agree with?

We agree that an appropriate degree of independence of the DSO from the DNO could help address concerns regarding potential conflicts of interest and so help boost the investment case for flexible services.

We agree that there is a case for integrating planning across energy vectors at a sub-national level; this will promote whole system outcomes and evenly spread benefits across regions

9. Out of the framework models we have developed which, if any, offer the most advantages compared to the status quo? If you believe there is another, better model please propose it.

- The lack of detail means it is difficult for Energy UK to express a clear preference for any of the framework models as described. Several EUK members are uncomfortable with Option 1, commenting that internal separation rarely works, and does little to deal with their concerns regarding potential conflicts of interest and transparency. Furthermore, members do not believe it will deliver the right framework to achieve a timely and cost effective net zero transition. Some of these members feel that the fact that DNOs have failed to sufficiently progress implementation of internal separation and supporting compliance frameworks demonstrates a need for more substantive reform.

- Whilst several members are in favour of complete separation, there is a view that any option should not lead to further contractual complications for the sake of it. In particular:

    - Lessons should be learned from the separation of the ESO from the TO whilst considering future governance at distribution level - despite separation, there are still issues delivering transmission network capacity; EUK is keen to avoid the same at a distribution level.
    - The degree of change at a distribution level should also be considered against the backdrop of changes elsewhere, i.e. creation of the FSO, as well as the development of flexibility markets more generally.
    - Additionally, there is a chance that complete separation could deliver the same or similar benefits as another model but with higher costs.
    - More formal separation should not impede the development of nascent DSO functions and capabilities and risk the development of associated flexibility markets.

- Some views have been expressed in support for a single, independent DSO, rather than a separate one for each DNO or region. There was also some support for this market facilitation role lying with the Future System Operator, allowing a single digital registry of assets and improving coordination between markets. Under any option, increased cooperation with the ESO is vital to increase visibility across the network and improve market coordination. In particular, DNO/DSO interfaces with ESO systems should not create any artificial incentives for people to connect one side of the distribution or transmission boundary/system. It is vital that we develop charging and smart systems that are fair, transparent and consistent; with a set of methodologies and clear consistent charging across the GB market.

- Finally, some EUK members have voiced support for a single cross-vector planning body, noting that the number of parties involved in the planning process creates an incoherent system and risks leaving regions behind.

10. What do you consider to be the biggest implementation challenges we should focus on mitigating?

We believe that it is essential that any implementation following this review does not delay the continued deployment of flexible resources, or the network buildout necessary to support widespread electrified heat and transport.

In addition, any implementation should not impede the ability and resourcing of local authorities to engage with all stakeholders, both distribution companies and connected parties, to help ensure a coordinated, timely and strategic plan for network development.

11. Taking into account the varying degrees of separation of DSO roles from DNOs under framework model 1, do you consider there are additional measures we should consider implementing, in particular in the short term (e.g. changes in accountability etc)?

As stated in our cover letter, many aspects of the DSO end-state have been consistent for a number of years. In particular, aspects of framework model 1 identified in the Future Worlds work could already have been in place by this point. Examples include internal separation, a single procurement platform, a clearly defined single set of products and transparency over the operation of embedded assets.

These are quick wins we would like to have seen progressing under the Open Networks project. The lack of progress stems from the absence of responsibility for the outcomes of the project. We would encourage Ofgem to step in to ensure these outcomes are expedited during the RIIO-2 period, in addition to clear progress on separation of DSO activities from legacy network activities.

12. Are there other key changes taking place in the energy sector which we have not identified and should take account of?

We agree that the regional perspective is lacking in comparison to the national one (i.e. FSO); however this Call for Input does not set out whether it will define a forward looking strategy (what should be in place at sub-national level, rather than what exists now). We also note that Ofgem is the regulator of heat networks, not of heat; therefore further clarity is needed on who would make the decision on heat on a regional basis. This is a key aspect when considering transforming the ways in which we generate electricity, heat our homes and power our vehicles.

We would again like to highlight the importance of cross-cutting digitalisation, and the opportunities this provides to the sector.

13. What do you consider to be the most important interactions which should drive our project timelines?

Any outcome of this project must align with the outcomes of the Future System Operator reform, in order to ensure accountabilities and areas for cooperation are clear. Coordination between any local energy institution and the FSO will be key to successful delivery across all three of the system functions identified.

In addition, it is important that there is clarity between Ofgem, BEIS and local government on the decision maker for the correct approach to a cross-UK energy plan, including the future of sub-national institutions.