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Citizens Advice's response to Call for Input: Future of local energy institutions and governance

Dear Ofgem,

Thank you for the opportunity to respond to this consultation.

We welcome the call for input on where Distribution System Operation responsibilities should reside in the future.

We fully support Ofgem's work to provide direction for local network system operation development because there are currently accountability issues, institutional gaps and challenges around the coordination of distributional system operation functions. However, we think Ofgem has taken a problematic approach with this 'call for input'. It is effectively asking stakeholders to choose, largely on principle, between institutional arrangement options.

At this stage, more evidence is required for stakeholders to make a reliable assessment. There is not yet sufficient clarity on the local system operation activities that will be undertaken by the proposed alternative institutions or the type and scale of consumer benefits potentially offered. We think that a cost-benefit analysis is required. The costs of regional institutional reorganisation need to be well-justified based on a clear positive value proposition with viable institutional arrangements.

Before local market institutional arrangements can be assessed on how they can contribute to regional value propositions to consumers, we think further clarity is needed on the role of the Future System Operator (FSO) and on market design reform. Once there is clarity on what efficient whole system operation, market functions and governance look like, the responsibilities and potential of local system operation to provide additional value should be clearer.

Patron HRH The Princess Royal Chief Executive Dame Clare Moriarty

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We recognise that in the meantime, as these reforms are in development, there are a number of activities Ofgem will need distribution networks to deliver during ED2. Networks should be tasked to provide decision-making independence and mechanisms to mitigate conflicts of interest. DNOs should also develop long-term strategies to deliver whole system value, including considering what potential economic and community value benefits can be offered by local system operation decision making. These longer-term strategies and propositions need to show evidence of how they avoid creating regional alignment and network user complexity challenges between regions. This activity should require networks to coordinate their activity more closely. We think this will be supported by Ofgem setting standards and offering incentives.

We think that eventually, Ofgem will need to commission assessments of where local system operation activity provides value to local consumers in each region and how these benefits relate to the overall costs of institutional change. This may require networks to adjust their planning assumptions.

Local systems within whole systems approach to design

Ofgem and BEIS Review of the Electricity Market Arrangements (REMA) are looking at options for locational pricing. This will impact the role of local markets, including the role of national and local system operators and their control of system design vs the role competition will play in shaping networks. The form of energy price signals that are applied will shape the scope of system operation at a national and local level. For example, the role of the system operator in network planning and in electricity dispatch will impact the role of local markets.

This is reflected by each of Ofgem's four possible local institutional arrangements' outlined as having their core capabilities (market facilitation, operation and planning) as highly dependent on the role of the FSO. Given the consumer benefits of an optimised national energy system, the ability of DSOs to support the delivery of FSO function is a key output of DSO institutional design. For example, DSOs need to provide clear signals about local system needs to support the optimally efficient location of transmission assets. Similarly, DSOs need to work proactively with transmission operators to make the network connections process more transparent and efficient to better meet network user needs. As a result, we think that clarity on the model of efficient national system operation and what the DSO's supporting role is within that context is the correct starting point for system design.

Optimising value for local communities

Eventually, we would like Ofgem to define what benefits they expect institutional arrangements of local markets can offer consumers and how this can be tracked and governed. We think these benefits will be lowering direct or indirect costs for consumers

or helping to meet specific local needs. We think it is important for distribution networks to pursue a better understanding of how local system operation capabilities are required to support these opportunities in ED2 and support a better starting point for a view on the case for change.

We think that local system operation requires a number of key technical competencies; but also clear scope to offer additional energy system value for consumers and strong accountability for decision making. Accountability of DSO activity is needed 'upwards' to the national system operator which needs to maintain fair consumer outputs across the whole system and also downwards to local communities to explain how it is optimising energy service.

These consumer outcomes could conceivably be achieved through a range of institutional arrangements and may differ by region. However, where there is apparent value in local decision making, the case for independence in decision-making increases and is more likely to justify the costs of institutional change. Individual regional assessments over how system control functions can be allocated to those that are best placed to manage local delivery and risks should lead to the most efficient design. This seems to be ultimately best placed as an evidenced-based position utilizing the expertise of the FSO, distribution companies and Ofgem with input from the industry. We are keen to see it is based on evidence of additional value for consumers of independent and local institutions.

Please do get in contact if you have any queries about the response.

Kind regards

Ed Rees

Senior Policy Researcher
Citizens Advice

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 agree these are the key outputs but they must include the role of local energy networks in whole system planning and providing accountability for local system decision making.

Each of Ofgem's four possible local institutional arrangements' outlined as having their core capabilities (market facilitation, operation and planning) as highly dependent on the role of the FSO. Given the consumer benefits of an optimised national energy system, the ability of DSOs to support the delivery of FSO function is a key output of DSO institutional design. For example, DSOs need to provide clear signals about local system needs to support the optimally efficient location of transmission assets. Similarly, DSOs need to work proactively with transmission operators to make the network connections process more transparent and efficient to better meet network user needs. As a result, we think that clarity on the model of efficient national system operation and what the DSO's supporting role is within that context is the correct starting point for system design.

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

We have no issue with the criteria listed. We would expect that the case for change would be based on the value proposition of institutional and governance impacting on energy system design value, which must be the key criteria.

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 agree that there are significant limitations of the current institutional arrangements but we think that there is scope to address a number of 'arrangement issues' in the short term by rescoping how DNO's objectives for DSO development.

Before local market institutional arrangements can be assessed on how they can contribute to regional value propositions to consumers, we think further clarity is needed on the role of the Future System Operator (FSO) and on market design reform. Once there is clarity on what efficient whole system operation, market functions and governance look like, the responsibilities and potential of local system operation to provide additional value should be clearer.

We recognise that in the meantime, as these reforms are in development, there are a number of activities Ofgem will need distribution networks to deliver during ED2. Networks should be tasked to provide decision-making independence and mechanisms to mitigate conflicts of interest. DNOs should also develop long-term strategies to deliver whole system value, including considering what potential economic and community value benefits can be offered by local system operation decision making. These longer-term strategies and propositions need to show evidence of how they avoid creating regional alignment and network user complexity challenges between regions.

This activity should require networks to coordinate their activity more closely and transparently. We think this will be supported by Ofgem setting standards and offering incentives.

We think that eventually, Ofgem will need to commission assessments of where local system operation activity can provide value to local consumers in each region and how these benefits relate to the overall costs of institutional change. This may require networks to adjust their planning assumptions.

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

The slow development of DSO competencies and alignment with national-level planning are key blockers, alongside a market design that does not properly incentivise the strategic planning and balancing of supply and demand.

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

We do not think the institutional synergies substantiate a case for change. The value of local energy system operation decisions will be from objective and well-placed decision making. We want to understand what this will mean for consumers.

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

No response.

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 agree with the risks set out.

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 think Option 4 presents the range of possible outcomes that can reflect that the case for change will vary by region and may require tailored approaches.

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.

We think Option 1 represents the best option in the short term and in the longer-term Option 4 represents the range of options that should be considered.

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

Evaluating the case for institutional change objectively while it is owned by DNOs. We think that at a later stage Ofgem should commission assessments on the institutional arrangements suited to local areas.

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)?

We recognise that in the meantime, as these reforms are in development, there are a number of activities Ofgem will need distribution networks to deliver during ED2. Networks should be tasked to provide decision-making independence and mechanisms to mitigate conflicts of interest. DNOs should also develop long-term strategies to deliver whole system value, including considering what potential economic and community value benefits can be offered by local system operation decision making. These longer-term strategies and propositions need to show evidence of how they avoid creating regional alignment and network user complexity challenges between regions. This activity should require networks to coordinate their activity more closely. We think this will be supported by Ofgem setting standards and offering incentives.

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

No response

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

Clarity on the FSO role and the outcome of REMA should enable a better assessment of the institutional arrangements that can best deliver distribution system operation functions.