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ESO Responses to Call for Input on the Future of Distributed Flexibility and Consultation on the Future of Local Energy Institutions and Governance

Thank you for the opportunity to respond to the Call for Input on the Future of Distributed Flexibility and the Consultation on the Future of Local Energy Institutions and Governance. This cover letter sets out our high level views in response to both documents, given the strong links between both policy areas and the proposed roles set out within them.

Who we are

As the Electricity System Operator (ESO) for Great Britain, we are in a privileged position at the heart of the energy system, balancing electricity supply and demand second by second.

As the UK moves towards its 2050 net zero target, our mission is to drive the transformation to a fully decarbonised electricity system by 2035, one which is reliable, affordable, and fair for all. We play a central role in driving Great Britain's (GB) path to net zero and use our unique perspective and independent position to facilitate market-based solutions to the challenges posed by the trilemma.

Our transformation to a Future System Operator (FSO) is set to build on the ESO's position at the heart of the energy industry, acting as an enabler for greater industry collaboration and alignment. This will commence with greater coordination across gas and electricity strategic planning, with the ability to expand our remit to include additional vectors as and when needed. This will unlock value for current and future consumers through more effective and joined up strategic planning, management, and coordination across the whole energy system.

The case for change

The scale of change needed to deliver a decarbonised energy system, demands urgent and collaborative action. This action includes a need for a shared, industry-wide vision of what is required both in terms of networks and markets to deliver net zero. We very much welcome, therefore, Ofgem sharing proposals for the sector through these, and other consultations such as Future Systems and Network Regulation.

The consultation and call for input we are responding to today demonstrate the importance of creating alignment across markets to remove barriers, particularly relating to market design, access rules and complexity, as well as the importance of creating a common digital infrastructure, to ensure that consumer value is maximised. The local governance consultation also highlights the gap in the current industry structure for an independent, neutral organisation at a regional level, that can determine solutions holistically across the whole energy system to support net zero aspirations.

Within these consultations, the FSO is proposed to undertake significant roles as the market facilitator and Regional System Planner (RSP), working at the heart of and engaging within the sector to provide leadership and deliver progress in these areas. We stand ready to play our part.

Proposed roles

Market Facilitation and the need for a common digital energy infrastructure

Flexibility, and increasingly distributed flexibility, is critical to GB's ambition of decarbonising the power system by 2035. Growth of distributed flexibility relies on providers being able to stack revenues across several markets, notably wholesale and balancing markets as well as transmission and distribution system services markets.

The full potential of distributed flexibility is being held back by both the lack of standardisation and alignment across ESO and Distribution System Operator (DSO) markets, and the need for a common digital energy infrastructure, and this is supported by industry feedback. We acknowledge that Open Networks has made some progress in achieving alignment among the network companies and has reflected stakeholder feedback in its new targets in its 2023 plan. Whilst this is moving in the right direction, progress needs to be accelerated to achieve the required growth in distributed flexibility.

We believe that a single, neutral entity should take on the central market facilitation role. A single point of accountability is needed to drive alignment at pace across transmission and distribution flexibility markets, to achieve coherency with wider markets, and to remove the barriers to scalability of markets in a timely manner. While standardisation of DSO markets will contribute towards the business case of distributed flexibility, this alone will not unlock the level of distributed flexibility required to meet our net zero targets. We believe the market facilitator will also have a role in facilitating wider market and policy alignment.

We also agree with the need to develop a common digital energy infrastructure across transmission and distribution, to facilitate the interaction between flexibility providers and market operators in a standardised, simplified and coordinated way. This would encourage providers to participate in a wider range of markets (and therefore increase revenue stacking potential), by reducing complexity and associated administrative costs. Ultimately, more liquid, and competitive flexibility markets will lower costs, delivering value to consumers. We will continue to collaborate with industry stakeholders as the requirements are defined to ensure the product meets all user needs as well as Ofgem's ambition.

Regional System Planner

There is a clear gap in the current industry structure for an independent, neutral organisation that can facilitate holistic solutions across the whole energy system to help regional stakeholders achieve their net zero aspirations. We believe that the RSP model can fulfil this. In fact, we believe the RSP will be essential in addressing current inefficiencies associated with not taking a whole system view and supporting GB consumers and communities in accelerating their journey to net zero at lowest cost.

It is critical that the RSP model is built with and for regional stakeholder needs. Their support and buy-in in developing the model will be invaluable to its success. A successful RSP can help to deliver optimum decisions through the investment planning process faster than current mechanisms and unlock best practices that are currently developed in silos across GB. The RSP role must enable whole system solutions and ensure optimisation at a regional level. To do this, the RSP will need to connect democratic mandates to the national strategy, ultimately ensuring that net zero is developed in a way that works for all.

FSOs remit around proposed roles

We strongly believe that the FSO is the only entity able to undertake these proposed roles. Not only will it have a unique voice, independence and expertise within the sector, but the new whole system mandate for the organisation will help drive the best and most efficient solutions to be delivered for consumers overall. In addition, there are specific organisational characteristics that we already have that will support the delivery of these roles.

In terms of Market Facilitation, the ESO has many years of experience in designing and operating flexibility markets that are coherent with one another as well as with wider markets. We use our market design framework to constantly reform our market designs, adapting to changing system needs as well as to an evolving landscape of flexibility providers. We do this in close collaboration with industry stakeholders, and our long-term reform strategy is published annually in our Markets Roadmap. This experience in strategic market reform, coupled with the FSO's new 'whole energy system' responsibilities, makes us a natural fit for the role of market facilitator.

We believe that the FSO is uniquely placed to deliver a common digital infrastructure to support distributed flexibility. We are also already developing a digital ecosystem for all ESO markets that provides a common platform for registration, prequalification, onboarding, contract management and data collection. We would propose to build on this to support the facilitation of distributed flexibility. The ESO Digitalisation strategy also covers other ongoing innovations; Virtual Energy Systems and Digital Spine which have some overlap with the call for input. We will consider the full role FSO will have around common digital infrastructure in due course, but with respect to this call for input we feel confident FSO is the right entity to support and deliver this. With regard to the RSP, as a national entity with applicable expertise in energy strategy and planning, the FSO will be able to build on existing frameworks such as Holistic Network Design (HND) to ensure there are consistent investment planning processes and assumptions across GB network organisations, and it is best placed to drive and coordinate local and regional strategies with overall national requirements. We recognise that our existing skills and capabilities will need to grow to successfully fulfil these roles.

Proposed next steps

As an organisation, and in particular as we transition to the FSO, we are keen to continue to work with Ofgem, national and local government, Distribution Network Operators (DNOs) and stakeholders more broadly, to develop thinking in these areas. To enable this to happen, it is essential that there is no hiatus, and proposals are developed into firmer arrangements so that consumer benefit can be delivered as soon as possible.

Specifically, we would ask for timely decision making and considered implementation of the proposed arrangements. This includes:

- Further development work to understand the benefits and impacts of the proposals, including impact assessments as appropriate.
- Establishing the correct governance and regulatory framework, including links to future regulatory arrangements. If this is not considered carefully, progress could be easily stalled, or sub-optimal outcomes achieved. It will be important that Ofgem provides the appropriate support for establishing new frameworks.
- Setting out clear accountabilities and roles of responsibilities between Ofgem, FSO and the wider sector in delivering the arrangements. This includes making sure that the right obligations are in place across the sector, for example around data transparency, in order for the proposed roles to be delivered effectively.

We look forward to engaging with you further. Should you require further information on any of the points raised in our response please do get in touch. Our response is not confidential.