

Balancing & Settlement Code Panel

5 February 2024

Dear Ofgem

MARKET FACILITATOR ROLE DECEMBER 2023 CONSULTATION RESPONSE

As Deputy Chair of the BSC Panel I have pleasure in submitting the Panel's response to this important consultation. I am leading this to avoid any potential conflict, or perception of a conflict, with Sara Vaughan's role of Elexon Chair.

The BSC Panel welcomes the opportunity to respond. As a group, the Panel members have a deep and wide range of relevant expertise in different sectors of the electricity market in the UK and internationally that can draw on decades of experience. Many Panel members have worked for a long time with or for organisations owning and running the very sort of assets that will engage in both the national and local flexibility markets; they therefore bring a valuable perspective.

We welcome the very even-handed position that Ofgem has taken in this consultation. We understand that some 10 out of the 80 responses suggested, without prompting, that Elexon should be considered as an alternative to the FSO to take on this role. It indicates a powerful undercurrent of opinion in the industry that Elexon should be considered seriously.

Whilst the Panel necessarily works closely with Elexon, it is independent in its determinations with regard to the best interests of market participants and has discussed this response in two Panel meetings. We would certainly feel comfortable with advocating the FSO over Elexon if indeed that is the balance of opinion. For example, if the role of the flexibility market facilitator were to promote the optimal integration of distributed flexibility services within the system balancing and other ancillary services currently undertaken by NGESO, we would indeed suggest that the FSO is best placed to create an optimal integrated solution. However, we do not interpret this to be Ofgem's intention. On the contrary, Ofgem has recognised that flexibility services have many different characteristics that preclude such an integration and present the need for an alternative operator and market arrangements.

While we can appreciate the pros and cons of the choice between the FSO and Elexon for this role, the Panel members' prevailing strong opinion is that, for several reasons, Elexon is better positioned to deliver the change and then lead it to maturity. Our response to each question is detailed below in the following pages.

You will be aware that NGESO is represented on the Panel through its Panel Member; please note that this response does not contain or imply any views from NGESO/FSO because it will be making its own separate response. Unless explicitly mentioned, the responses represent the views of the great majority of the remainder of the Panel, excluding the NGESO Panel Member. For obvious reasons, the Ofgem Panel member has also recused themselves.

We would be very happy to discuss any of the points made in this response or answer further questions if appropriate.

We are content for our response to be made public.



Dr. Phil Hare

BSC Panel Deputy Chair

Balancing & Settlement Code Panel

1. Do you agree with the proposed market facilitator design principles (in paragraphs 2.22 - 2.28)? If not, what additions or changes do you suggest?

Note that the NGESO Panel member has recused their opinions as discussed in the covering letter.

We recognise that there are many complexities involved in facilitating this market. Achieving an efficient design for it is complicated by the many interactions between the FSO, DNOs and aggregators and suppliers, as well as their underlying drivers. For example, whilst the FSO may see the flexibility enabled by the market facilitator as an extra system balancing resource, for DNOs it may be an alternative to physical investments, and market participants may see it as alternative energy resources. These interactions are awkward and temporal. Academic research and ACER favours having a **fully independent** facilitator because of the need to resolve private information opacities as well as to demonstrate a lack of bias in actions. Ofgem may wish to consider strengthening the “impartial” principle rather to reflect a principle of “independence”.

While the need for “pace” is clear, the design principles should recognise that doing so will necessarily also involve some risk taking, and the appetite for this could be made clearer. We suggest that the design principles should include some appreciation of the tolerance to risk taking.

We question the definition of “expert and strategic”. There seems to be an implication that the facilitator should be able to “outrank” or “trump” parties with its expertise, taking an approach of presenting “solutions” that can then be commented on by the parties. In our view it is important that the market facilitator has sufficient expertise to engage with different parties and understand their concerns and develop acceptable solutions, but no more than that – the position of industry as the key source of expertise must be respected.

We would like to see explicit mention of Project Management skills (and attendant governance design and operation) in the Principles – either in this, or explicitly elsewhere. This currently feels like an omission.

A second aspect we believe is missing is facilitating market access for participants. The Panel has heard repeated complaints from parties where standard Ts&Cs appear to be onerous or outdated. By way of an example, the continued requirement for fax connections for Balancing Mechanism (BM) participation has proved a sticking point for many. The overriding principle should be that Standard Terms should be as simple as they are able to be, should reflect modern industry practice, should be fair and should not create unnecessary entry barriers.

2. Do you think some of the design principles are more important than others? If so, which should we attach greater weight to?

Note that the NGESO Panel member has recused their opinions as discussed in the covering letter.

In the light of the general views made in response to Question 1 already, it is hard to disagree with any of these seven. However, the Panel would suggest prioritising:

- “Inclusive and collaborative” because this success will crucially rely on industry working together in a way that, as set out in the Call for Evidence, does not seem to have happened so far. Several Panel members lauded Elexon’s historical way of operating to get industry participation (for example, treating large and small players in a non-discriminatory fashion) as working well in similar situations, rather than solely relying on building a strong in-house resource to develop solutions without external input. Without the trust, and consequent engagement, many Panel members felt the initiative was highly likely to stall;

Balancing & Settlement Code Panel

- “Impartial” (or rather “independent”) because many in the Panel have concerns that, as the ultimate buyer of the flexibility services, the FSO is conflicted, or there is a perception of a conflict and market power, which will reduce Parties’ engagement. Others on the Panel took a different view: that, whatever the historical functions of NGENSO have been, one of the central aims of the FSO is to establish a central body that can make strategic decisions independent of commercial interest. One Panel member views the slow progress of the Open Networks programme as being essentially due to the limited incentives on monopolies – the network companies – to work together and had concerns that this dynamic would be perpetuated by the FSO;
- On “agility”, we believe that the organisation and the governance arrangements will need to be agile in the sense that they are able to rapidly adjust to a new-born market in a fast-changing world. A Code-based approach, with its attendant governance arrangements, would seem ideal for this.

Being “transparent” should be a given for whichever organisation is selected. While it is a valid point, it is very difficult to use this to form an opinion on the likely behaviour of the chosen organisation. Perhaps Ofgem should rely on industry opinion on the “transparency” of Elexon and NGENSO in recent activities. We would also suggest that the transparency be extended to include costs, so that industry can be sure it is getting value for money.

3. How important is it for the market facilitator to be able to align transmission and distribution flexibility market arrangements? Why?

Note that the NGENSO Panel member has recused their opinions as discussed in the covering letter.

It will be, of course, vital that the transmission and distribution flexibility arrangements work effectively with each other.

However, many on the Panel took the view that a large integrated dispatch process currently run by NGENSO is likely to disfavour small local resources (of the kind that can help) and could quite possibly stifle the innovation needed in this market. One Panel member recalled parallels to the way in which Nordpool repeatedly failed to sell its Nordic electricity market design to countries with very different social values and different generation mixes.

There is a huge difference in the scale of actions between local flexibility calls and system balancing, and it will be important that the market facilitator does not try to “shoehorn” their own market “comfort zone” into a very different situation. Distribution connected assets have completely different drivers to those connected at transmission level and often very different commercial expertise in their organisations, and many Panel members felt that this would be a challenge for the FSO to embrace.

Others on the Panel took the view that a key reason for the FSO being created was to overcome the conflicts of interest that NGENSO currently has in creating visibility for the distribution level flexible assets, and therefore they did not believe that it was reasonable to simply transfer these concerns to the FSO which will have to understand all segments of the system.

What should be the same in both transmission and distribution flexibility market arrangements is their general principles and equality of access and non-discrimination.

We do have some concerns that there is an inference that could be drawn from this question that the alignment between transmission and distribution is best achieved by both arrangements being

Balancing & Settlement Code Panel

delivered by the FSO. Many Panel members do not believe that this argument holds: Open Networks appears to have made little progress in the last five years. A Panel member suggested that, from a distance, it would appear that the DNOs and NGENSO have each been working in their own domain to little coordinated effect, and it will be a challenge for the FSO to break out of this mould.

While many parties deal with both the DNOs and NGENSO, in our view NGENSO has somewhat less experience in accommodating smaller parties than the DNOs. The great majority of Panel members felt Elexon may well strike a better balance in understanding both sets of viewpoints and business needs.

We repeat the point in our response to later questions, but there is a strong feeling in the Panel that the FSO will have significant challenges in building its new organisation over the next few years; and that there is a distinct possibility that this role would be competing with many other priorities. The dangers of overloading the FSO should be considered in any decision.

4. How important is ease of implementation and enabling a smooth transition when considering the market facilitator delivery body? Why?

Note that the NGENSO Panel member has recused their opinions as discussed in the covering letter.

Ease of implementation and enabling a smooth transition are, of course, very important in getting this new market up and running with active participation from all stakeholders. However, the Panel is concerned that, underlying this question, there is a tacit assumption that selecting the FSO would be the best way to ensure that this transition is as smooth as it could be.

Several Panel members have voiced concerns that NGENSO does not have a particularly good track record in delivery of new IT systems: for example, the Capacity Market Portal is two years late now, and the removal of the storage element of the Open Balancing Platform (OBP) has not been well received. One Panel member mentioned NGENSO's history of consulting with Parties but then seemingly ignoring their responses, such as in the way systems work, changes to service terms, metering requirements etc. A third party might well be able to strike a better balance than has historically been seen between the service providers and the service buyers.

At a broader level, we have some concerns that Ofgem (and, indeed, possibly also DESNZ) will see the FSO as the de facto default delivery organisation for any new developments in the electricity/energy markets going forward. Just because it appears the easy option, this should not necessarily be the case and Ofgem should avoid risking overloading it with new initiatives, especially during a period when it will be clearly establishing a new organisation.

5. Do you agree with our assessment of Elexon's suitability for the market facilitator role? If not, why not?

Note that the NGENSO Panel member has recused their opinions as discussed in the covering letter.

While some Panel Members took the view that both Elexon and the FSO were credible candidates for the role, the majority believed that Elexon is better placed to carry it out for several reasons and on a number of different levels. They suggested that the consultation assessment could actually be significantly more favourable towards Elexon. We discuss the reasons in more detail below:

- Elexon is already well engaged with the community of flexibility providers and well acquainted with the business and structural challenges they face in realising the value of their products – more so than NGENSO. Over many years the BSC has built a strong track record of overcoming in a practical way market barriers such as visibility, lack of coordination and common processes, and lack of transparency on decisions about the services.

Balancing & Settlement Code Panel

- The role of a balanced, multi-party Panel in overseeing the development of the market under the BSC has worked very well and over many years. It can give very fast feedback to the Code Administrator and has an ability to be far more agile in adapting to changing conditions. There are very good parallels to the early days of NETA when the new market had to iron out many urgent issues in a way which reflected and balanced the needs of all Parties. It is almost inevitable that the early days of this market will face similar challenges to be agile.
- The Panel does not share the concerns expressed in the consultation over governance. Necessary modifications to allow Elexon to carry out this work are not likely to be a problem as the Panel is already engaged and supportive. Governing through licence conditions, whilst useful, also creates its own issues: for example, lack of agility in modifying conditions, slowness of compliance and enforcement processes, bureaucracy and formality. And incentive mechanisms can be cumbersome and slow, creating “cottage industries” arguing about them, as well as creating a lot of unnecessary costs to the industry. Historically, Elexon has taken its responsibilities very seriously and we ask Ofgem to single out any situation where Elexon has failed to deliver to its accountabilities, or indeed, has refused to carry out something sensibly asked of it by Ofgem, as the Panel could not think of one.
- In terms of whether Elexon has suitable resources, Ofgem should first consider in more depth the actual management and skills and people needed to carry out the Market Facilitator role. We would suggest that this includes project management, IT development and delivery, adequate technical understanding, the ability to run consultative processes and act on the feedback provided, managing the development of a market [through a Code, most likely]. In terms of strategy skills we suggest due recognition should also be given to Elexon for its role as the MHHS Design Authority and now in implementation of the Programme. Elexon’s expertise in the carrying out of line-loss modelling is also worth mentioning, as that involves commissioning a large scaled detailed load flow model and regular monitoring of parameters.
- We recognise that Elexon will have to hire sufficient resources and increase its skills in some areas, but so would the FSO (on the reasonable assumption that both organisations’ staff are already fully occupied). As a smaller organisation, Elexon may be less resilient to staff movements, but not materially. One Panel member suggested that it is more likely that Elexon will be able to keep the same team throughout the project to give better continuity, although others suggested that this would be a management choice of either the FSO or Elexon.
- Finally, whichever organisation is selected for the role, Elexon and the FSO will have to work very closely together. We have seen over many years a good cooperation between them: there are many relevant modifications that are the result of this.

6. Do you agree with our assessment of the FSO's suitability for the market facilitator role? If not, why not?

Note that the NGESO Panel member has recused their opinions as discussed in the covering letter.

The Panel largely agreed that the assessment in the consultation was fair, and some Panel Members particularly expressed an opinion that both organisations were credible candidates. However, many Panel members believe that it underplays some important concerns as discussed below:

- Considering the FSO to be better placed because it can be governed through its licence should be re-examined. In principle the licence gives Ofgem a direct channel of governance which is discharged through NGESO’s price control framework. However, the very fact that NGESO

Balancing & Settlement Code Panel

continues to lose money under its incentives suggests that overall this approach, if also placed on the FSO, does not guarantee results. In contrast the more direct governance of Elexon gives parties the ability to remove directors, call EGMs etc if the organisation is not delivering, and may well be more suited to this situation.

- Panel members noted the long historical involvement NGENSO has in market design and many felt that the FSO would have the desired strategic skills.
- Some Panel members have expressed concerns that NGENSO's track record on delivering at pace is poor, often with slow decision making that would not augur well for the Market Facilitator role.
- We have already expressed deep concerns in the Panel that Parties may engage far less well with the FSO because of its position as ultimate buyer of the services. Parties have voiced concerns to some Panel members that the FSO has less experience of dealing with Distribution-connected parties and less appreciation of their business concerns. Gaining the trust of these parties may well be a significant problem for the FSO – when historically NGENSO has necessarily dealt with a very different community.
- Undoubtedly, the Open Networks Steering Committee membership will give the FSO very useful insights, but it should also be recognised that the project has not made a great deal of progress. Elexon already has a good and practical interaction with Distribution based parties through its normal business and has been specifically engaging with them in relation to this role. If Elexon is seen as a credible candidate, perhaps Ofgem should ask Elexon to start attending the Open Networks Steering Committee anyway.

7. Do you believe Elexon or the FSO is better suited to take on the market facilitator role when considering the design principles and wider considerations?

Note that the NGENSO Panel member has recused their opinions as discussed in the covering letter.

It must be acknowledged that, in its central role in our industry, the FSO is bound to attract an undue proportion of negative opinion, not all of it fair or reasonable.

The main aim in choosing a market facilitator needs to be to select the one that has the highest chances of success in the face of many major challenges – some technical, but many due to the nature and number of parties involved.

FSO is taking on the tremendous challenge of leading the country towards the low carbon transition, but that doesn't mean it has to do everything. In fact, quite the opposite – it can achieve its goals better by, through and with, other organisations. Ofgem needs to review the risks of creating a significant single point of failure in the delivery of its strategy.

Overall, Panel members believe that while it could be argued that the FSO could become the default organisation for this sort of role, there are some very good arguments for Elexon in this case.