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Dear Joseph,

SSEN Distribution response to the Consultation on the Market facilitator delivery body

1. Thank you for the opportunity to respond to this consultation on the Market facilitator delivery body. This response is on behalf of Scottish and Southern Electricity Networks' two distribution licence holders: Scottish Hydro Electric Power Distribution plc and Southern Electric Power Distribution plc.
2. As we stated in our response to the Consultation on the Future of Local Energy Institutions, we agree with the need for this market facilitation role. We welcomed the position set out in the decision document of 15th November on what that role should entail. In determining the right delivery body to take forward this role, this is a key opportunity to consider in more detail the capabilities required for the market facilitator, and weigh these up against implementation challenges.
3. In this letter we give our thoughts on the content and prioritisation of the criteria set out in the consultation, including the balance of implementation versus suitability. We also reiterate the need for continued momentum in flexibility market development and standardisation, as recognised by Ofgem in the decision document and letter to industry. A key step in realising this is shifting from bodies acting as code administrators to code managers, which can significantly enhance the facilitation of flexibility markets.
4. We believe both candidate organisations, Elexon and NESO, have the potential to be strong market facilitators. While both organisations have strengths and weakness, on balance we believe Elexon's natural independence from flexibility procurement and RESP activities better address concerns around neutrality and impartiality, which we consider to be critical criteria.

Distribution flexibility markets require their own approach

5. Both the parties considered have significant experience in administering markets, but it is important to highlight that there are significant differences of purpose in the use of flexibility at distribution compared to the Balancing Mechanism and associated services the NESO procures.
6. The services are very different, with respect to basic market definitions: products; time horizon; need; location etc. There is more in common between the frequency response market and transmission flexibility service than there is between distribution and transmission flexibility services. Distribution markets focus much more on local issues, have less liquidity and, whilst they may be more nascent, focus on coordination

and encourage service stacking in order to increase overall participation. As such, expectations should be managed for how quickly any market facilitator can develop relevant capabilities. That said, we strongly seek, and are working towards, better alignment between markets, at least to enable market and operational coordination and avoid contrary actions.

7. As recognised in the assessment of each candidate, whoever takes on this role will have to develop new capabilities, in addition to new IT infrastructure requirements. These developmental requirements make the proposed timeline for delivering market facilitation challenging, but is not a strong differentiator between the candidates; the level of development required by each is a similar scale of change.

The timeline for implementation should be ambitious, but not the sole determinant

8. We agree with setting an ambitious timeline to introduce this role, and this does therefore form a component of assessing the candidates. We would, however, stress that even if implementation is likely to take longer for either candidate, this should not be the sole determinant of which option is progressed.
9. Markets have seen significant development and standardisation without a fully realised market facilitator, and thus ensuring the right governance arrangements is equally, if not more, important than speedy delivery. Markets can continue to be facilitated by DSOs with collaboration and the ENA (predominantly through Open Networks) driving standardisation wherever practicable. If implementation would take longer for one candidate there is unlikely to be significant detriment to the market environment (unless the relative delay is multiple years). It is therefore more important that design and implementation are well executed.

Neutrality is a key factor in effective facilitation

10. Our view on the different design criteria is that neutrality and an intrinsic 'curiosity' to understand all details without assumption are the most important characteristics, as this drives confidence in the market environment. While the capability of the facilitator will also be a key factor in market confidence, capability can more readily evolve than neutrality. The right incentives and independence for the facilitator must be 'designed in', while the expertise of the delivering organisation can develop more over time.
11. As a user of flexibility in order to manage network reliability and safety, it is critical that we have high confidence that we will have stable access to resources procured through the markets, with well understood rules and contingencies. Neutrality is at the centre of this, as is decision making transparency.
12. There are key perceived conflicts to manage with both candidates. For the NESO, this arises from facilitating flexibility markets where it may also procure services from those same resources to manage the system. Elexon on the other hand is owned by suppliers; suppliers can act as aggregators and thus be providers of flexibility resources to these same markets. We consider this, though, to be less of a concern for Elexon given the proven arrangements in place for independent governance.
13. These potential perceived conflicts can be managed in both cases; strong governance and transparency in decision making are key to demonstrating neutrality for either party.

Accountability and incentive structures can be delivered through the right implementation

14. Market facilitation drives several key outcomes for the DSO/DNOs. For example, network reliability can be in part driven by the availability of flexibility service providers (facilitated and incentivised by market structures), while flexibility usage and cost depends on liquidity which is driven by facilitation.
15. Network reliability is clearly an accountability of the DNO, and the DNOs' performance is also incentivised in this area to drive constant improvements. This strategy has been successful over a number of years in driving reliability improvement across the industry. In a similar way, a market facilitator must become accountable for market facilitation, and incentivised to drive improvements continuously.
16. Ofgem discuss their views of how implementation would work for both candidates. While these approaches seem reasonable, we would welcome further discussion on other possibilities for implementation. For instance, we believe licensing code managers is a promising strategy (that is not discussed in the consultation) for making code management more agile and inclusive, while clarifying and driving accountability. It is not clear how licensing could work in the context of the NESO.
17. Whilst we do not consider Elexon's existing principal code (the Balancing and Settlements Code) as the right basis for establishing new DSO/NESO/Wholesale facilitation, we do believe a new code with appropriate governance could be the future basis for greater coordination. The use of the BSC as a short term 'vehicle,' if limited, could give an appropriate basis for developing this role, whilst a more appropriate alternative to the BSC is developed in parallel. DNOs do not have appropriate input into the BSC to consider its reuse for wider flexibility development.
18. Implementation also does not consider if dividing the market facilitator role between both candidates is credible. Such a split could mean the relative strengths of each organisation are best deployed across different aspects of the role, or the complexity of accountabilities and implementation may make such an approach ineffective. We do not however consider this option as likely to be optimal, given the additional complexity it introduces and the dilution of accountability for a holistic approach to market facilitation.

Next steps

19. Please find attached appendix 1 answering the questions as set out in the consultation.
20. We look forward to continuing to work with you on the development of this pivotal role for the industry, as well as continuing to develop, facilitate and improve our flexibility markets in the interim.

Yours sincerely,

Alasdair Muntz

Regulatory Strategy Manager- SSEN Distribution

Appendix 1: Consultation question responses

Q1. 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?

- 1.1. We agree with the design principles set out, with the addition of 'incentivised'. This could be part of the accountability principle. To hold the facilitator to account, the incentive properties of potential implementations should be carefully considered at the design stage.

Q2. Do you think some of the design principles are more important than others? If so, which should we attach greater weight to?

- 2.1. While all of the principles are important and should be fulfilled, there is value in a degree of prioritisation. This is partly because some principles can be developed over time, while others must be 'baked in' to how the role is implemented.
- 2.2. Impartiality, and the perception of impartiality, are critical to participants having confidence in the market, which is the cornerstone of effective market functioning. This means the confidence that rules will be developed in a fair and stable way, such that investing effort in participating in the market and overcoming barriers to entry will be worthwhile. There are many paths for how the role is enacted, be it through licence conditions, frameworks applied to code administrators, requiring third party monitoring etc. These design choices are the first that must be delivered to institute the market facilitator, as well as the hardest to subsequently change- and will materially impact the long-term perception of the facilitator.
- 2.3. Accountability is equally important, given the centrality of this role to the industry. Accountability drives performance, giving market participants confidence that the market facilitator is incentivised and obliged to meet their needs. Again, accountability of the organisation arises out of implementation design choices that will be difficult to subsequently change.
- 2.4. Transparency, and its implementation through robust governance, measurement and reporting processes are the key tool for demonstrating impartiality, and therefore are also a top priority.
- 2.5. The remaining principles are also important. The way impartiality, accountability and transparency are implemented in governance and regulation should drive the market facilitator to ensure it develops and maintains the relevant behaviours. A key behaviour in this development that is not mentioned is curiosity; a willingness to learn from the existing distributed flexibility landscape to maximise continuity, benefit from existing learning and accelerate the development of all facilitator functions.

Q3. How important is it for the market facilitator to be able to align transmission and distribution flexibility market arrangements? Why?

- 3.1. Coordinating between these markets (distributed flexibility, balancing and to an extent wholesale markets) is a critical facet of the facilitator role. This is because one of the central complications in running distributed flexibility markets is that flexible resources stack revenues across multiple markets to maximise value (for both buyers in providers across these markets). This stacking means rules and processes must

be in place to clarify all participants rights and duties as the pertain to all interacting markets and the physical capabilities and obligations of the electricity networks.

- 3.2. This clarity is key to sellers maximising value by being able to sell capacity and services to a range of markets wherever possible, as well as reassuring buyers that they will be able to meet their obligations (such as network reliability and safety) with procured services or understood alternatives. Even more importantly, the coordination of all the markets is critical for minimising overall system operation costs and costs for the end consumer, and all system operators should be working together to minimise this cost. Maximising market access is a key element of this, as is neutrality in facilitation to ensure all contributions to system costs and benefits are fully recognised.
- 3.3. An important use case for the markets is to understand what happens when services are not delivered. A difference between meeting national system needs and local distribution needs in these instances is liquidity; the Balancing Mechanism can generally provide an alternative solution at short notice, while localised issues in distribution markets may have to take different, non-market actions where services are unavailable as contracted, which may include unplanned outages. Understanding a wide range of use cases for flexibility resources, and acknowledging differences like the example above, are key to ensuring distribution and transmission markets work cohesively.

Q4. How important is ease of implementation and enabling a smooth transition when considering the market facilitator delivery body? Why?

- 4.1. Ease of implementation is important in the sense that the sooner the role is in place, the sooner it will start realising value for participants and ultimately consumers. However, the ease of implementation is not as important as ensuring the implementation results in the right impartiality, accountability, performance incentives, transparency and governance. The ambitious timeline set out in the consultation means this will be a challenge.
- 4.2. The arrangements pre-transition, of DSO facilitated markets with collaboration and the ENA (predominantly through Open Networks) driving standardisation wherever practicable, can continue to evolve and ensure that while the market facilitator is being realised momentum will be maintained.

Q5. Do you agree with our assessment of Elexon's suitability for the market facilitator role? If not, why not?

- 5.1. We broadly agree with the analysis of Elexon's characteristics compared to the principles set out, however we would query if the implementation strategy explored would be the best path forward.
- 5.2. The path to implementation and potential implications set out in 3.6-3.9 may not be the only way to enact this industry change. Specifically, the feasibility of converting Elexon to a licenced code manager (from its current status of code administrator) could be clarified- such an approach could resolve accountability issues through a licence and may be within scope of existing Ofgem powers. Equally, the list of

governance models explored (as mentioned in 3.11) and why they were discounted would be useful supplementary information.

Q6. Do you agree with our assessment of the FSO's suitability for the market facilitator role? If not, why not?

- 6.1. We broadly agree with the analysis of the NESO's characteristics compared to the principles set out, however we would flag an additional concern about impartiality and awareness bias, given the risk of misaligned incentives on cost of system operation management on the FSO and DSOs.
- 6.2. The discussion of an implicit bias towards transmission omits the challenge to impartiality discussed in the accompanying letter (paragraph 12), which is that the NESO will continue to be an active purchaser of flexibility for solving national, system wide issues. While this role is critical to the system, there is the risk of bias towards easing how the NESO fulfils these responsibilities (including through the procurement of distributed flexibility resources) with market design choices. Market design choices should be based on a neutral approach that drives best value across all users of flexibility in an impartial way. Governance processes and transparency would therefore need to be designed to mitigate any perception of this.

Q7. 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?

- 7.1. Either organisation could take on the role with the right implementation steps, however we feel the easier transition would be for Elexon to assume the role. As outlined above, we believe that what's critical is that the selected organisation is set up with the right accountabilities, governance and process transparency to give confidence that the market facilitator role is being executed impartially, with recourse for market participants to hold them to account.
- 7.2. It could also be possible to split the role between the two organisations, a strategy not analysed in the consultation. Exploration of this option may find that by splitting these responsibilities in the right way, the characteristics of both organisations could result in the optimal delivery of all market facilitation functions. We do not however consider this option as likely to be optimal, given the additional complexity it introduces and the dilution of accountability for a holistic approach to market facilitation.