

28 September 2021

By e-mail to:

Dear Future System Operator (FSO) Consultation Team,

Re: Proposals for a Future System Operator role

Thank you for the opportunity to respond to this consultation. Below we provide a summary of the key points for our response and follow those up in detail in our answers to your questions, which we believe are relevant to ourselves.

Elxon welcomes the proposals from BEIS/Ofgem and is committed to making the arrangements work and will help BEIS/Ofgem in whatever way we can to make delivery of the arrangements easy to implement.

Elxon is the Code Manager for the Balancing and Settlement Code (BSC), which facilitates the effective operation of the electricity market. We are responsible for managing and delivering the end-to-end services set out in the BSC and accompanying systems that support the BSC. This includes responsibility for the delivery of balancing and imbalance settlement and the provision of assurance services to the BSC Panel and BSC Parties (energy Suppliers, generators and network companies). We manage not just the assessment, but also the development, implementation and operation of changes to central systems and processes. In addition, our expertise is available to support the industry, government and Ofgem in considering future changes and innovation against the existing industry rules, for the benefit of the consumer.

Elxon is a not-for-profit company, set up as an arms-length subsidiary of National Grid ESO (Electricity System Operator).

In addition, through our subsidiary, EMR Settlement Ltd, we calculate, collect and distribute payments to Contract for Difference (CfD) generators and Capacity Market (CM) providers, on behalf of the Low Carbon Contracts Company (LCCC). These services are provided to LCCC through a contract and on a not-for-profit basis.

Executive summary of Elxon's position

- Elxon is a subsidiary of National Grid ESO and therefore **Elxon is directly impacted by the proposed introduction of the Future System Operator, as well as the Codes Review**
- We believe that it is rightly recognised **that Elxon's independence is of value to Government, Ofgem and the industry and should be maintained** – we are pleased that this has been acknowledged by BEIS/Ofgem in the consultation
- **We are supportive of the objectives of both the Codes and System Operator Reviews**

- **We believe that the proposed framework set out by BEIS/Ofgem is a sound footing on which to build the future energy system** needed to deliver Net Zero and would support the choreography of change set out by BEIS/Ofgem, which implies that FSO and Strategic Body (under the Codes Review) will be decided on first, after which the practical proposals for **consolidation and simplification should follow in a subsequent phase, once the framework is in place and it is clearer what future structural change would best serve delivery of Net Zero**
- **Elxon does not have a preferred option in relation to ownership** of the proposed Future System Operator (FSO). We are committed to work well with any of the proposed models, but wish to express some concerns should the decision be for a public sector outcome
- We believe **it is important that the FSO maintains independence not only from industry but also from government**. This will be key to its credibility and effectiveness
- Elxon believes that **if the FSO is to be an arm's-length public body it should have an independently appointed and managed board of directors and leadership team** with clear accountability
- Given the number of expected changes and developments in the energy markets, we are concerned that being a public body could mean that the future FSO is subject to more bureaucracy, policy constraints, reviews etc. than necessary, which may ultimately lead to it being slow in its reaction to changes
- **The FSO will need to be appropriately resourced and the management effectively incentivised**, which may not fit within government imposed guidelines/policies
- As a subsidiary of NG ESO, **we would be concerned if there were to be constraints on Elxon's ability to manage its business** including the imposition of policies and procedures by government. Among other reasons, we are concerned these new policies and procedures could make Elxon less agile and responsive to future market changes; could make us less able to attract the right talent and expertise; and would cut across our independence and accountability to industry.
- **We would however like to see more clarity as early as possible on the overall FSO reform timeline**, in particular an indicative start date to allow us, and the industry more generally, to plan resources and determine any potential risks to ongoing initiatives
- In Elxon's own case, it is clearly important that **Elxon should not be distracted from delivering the Market-wide Half Hourly Settlement (MHHS) reform and the re-development of the industry central systems, which should deliver ~£4.6bn benefit to consumers** – itself a really important building block in the delivery of arrangements to support Net Zero
- Moreover, we want to ensure that uncertainty is minimised, as **we need to retain our industry experts to aid us in delivering net zero critical change such as MHHS**. In this context, we would highlight the value of the end-to-end service that Elxon offers, which provides a holistic “one stop shop” to industry – this important service and offering should not be jeopardised.

In our response to the consultation questions below we focus on those questions where we believe we can add value and outline practical considerations and suggestions based on our role at the centre of the market.

If you would like to discuss any areas of our response, please contact Angela Love, Director of Future Markets and Engagement on 020 7380 4156, or by email angela.love@elxon.co.uk or

Alina Bakhareva, Head of Strategy, External Affairs and DA on 020 7380 4160, or by email at alina.bakhareva@elexon.co.uk

Yours sincerely,

Mark Bygraves
Chief Executive

Proposals for a Future System Operator role: governance framework – answers to consultation's questions

Q.2 Do you agree that the establishment of a Future System Operator is needed to fulfil the kinds of technical roles needed to drive net zero?

Yes, the FSO will have a key role to play in the energy industry transition to net zero along with BEIS, the industry and the companies who provide central market services and systems.

Q.3 Do you agree that a Future System Operator should have roles in both the electricity and gas systems?

We strongly agree that a FSO should have roles both in the electricity and gas systems. This will allow for a number of positive developments; to name a few:

- Harmonisation across the two markets, which are inter-linked
- Dissemination and prompt application of best practices from one market to another
- Joined-up approach to upcoming market changes in electricity and gas
- Planning of changes in a coherent and coordinated way
- Potentially, more streamlined services to new market entrants;
- Potentially, a better way to support innovation and new business models across the two markets.

Q.5 What issues are there with existing institutional arrangements in the UK energy system in relation to system-wide decision-making and planning?

The issues are well-documented and widely discussed, most recently under the Codes Review Consultation in 2019 and Energy Code Reform: Governance Framework in 2021 (open alongside the present consultation on the Proposals for a Future System Operator Role: Governance Framework).

Many issues stem from the fragmented nature of the central market arrangements which is why we have been calling for consolidation of code bodies. Following the two most recent consultations (Codes 2021 and FSO 2021), if consolidation is not to occur immediately, we believe that it would be prudent for consolidation and simplification to be delivered in a subsequent phase, as soon as the framework of the Strategic Body and FSO is in place and it is clearer how best to set up the industry to deliver net zero.

Q.7 Where should government focus in our efforts to improve systems thinking and coordination across the energy system?

We believe the government focus should firmly be on establishing the new market frameworks to support the energy industry transition to net zero. Any proposed changes should be firmly set on actionable, practical steps rooted in evidence and cost-benefit analysis. Where verifiable best practices exist, these need to be taken in account and built upon to aid the transition and maintain stability of the market arrangements during this unprecedented time of change for the industry and society as a whole.

While bringing about new improved systems thinking and coordination, government should also consider the implementation timelines for the following initiatives and industry developments, as they pave the way to a net zero energy system and rely on the same organisations develop and implement the proposals:

- Energy code reform: governance framework
- Market-wide Half Hourly Settlement
- REC and Faster Switching including the new Centralised Switching Service (CSS)
- DNO to DSO transition and local balancing markets development
- Review of DCC licence arrangements
- Reforming the Framework for Better Regulation
- Strategy and Action Plan to digitalise our energy system
- Energy retail market strategy for the 2020s

Q.8 Do you agree that the FSO should undertake all the existing roles and functions of NGESO? If not, please explain why.

Yes, we agree that there is a clear merit in the FSO undertaking all the existing roles and functions of NGESO. Separating some functions out is likely to lead to unnecessary fragmentation of the FSO roles, functions and processes.

Q.9 Do you agree there is a case for the FSO to undertake the long-term strategic functions outlined in Option 1? Please elaborate and provide any views on the functions we have outlined in Option 1.

We agree that there is a case for the FSO to undertake the long-term strategic functions outlined in Option 1, namely: strategic network planning, long-term forecasting and market strategy function.

Q.10 Do you agree that there is not currently a case for the FSO to undertake all GSO roles and functions, including real-time gas system operation, as outlined in Option 2? If you do not agree, please explain why.

We agree there is not currently a case.

11. Do you have views on the proposal for an advisory role? What organisations do you consider would benefit from the provision of advice by the FSO? Who should bear the costs of providing that advice?

We believe it is important for all main bodies in the energy industry to work together and be able to share information and knowledge where it is required and needed. This includes the FSO as one of the main actors in the energy market structure. The FSO will need to be appropriately resourced to undertake this function effectively.

In our view, the cost of providing such advice should be included into the FSO cost base. However, we believe this activity should be only for key organisations in the sector, to ensure that there is not a large burden on the FSO. We agree with those organisations listed in the consultation, BEIS, Ofgem, other central bodies (Code managers and central systems delivery bodies), the CCC, and local authorities.

12. Do you have any views on the other areas where we are considering new and enhanced roles and functions for the FSO (outlined in section 3.2)?

We believe that new and enhanced roles and functions for the FSO need to be considered carefully against those of other bodies, e.g. Ofgem, other code bodies, to avoid duplication of functions and confusion among market participants. Where new market-wide roles and functions evolve (e.g. heat and transport decarbonisation), these can be undertaken by the FSO, once it is fully formed. Where functions (and the underlying infrastructure) already exist and deliver to the market participants' satisfaction, there needs to be a case-by-case assessment where these functions most naturally belong in the new market structure.

Q.13 What are your views on our proposed characteristics and attributes of a future system operator and how the models presented would deliver against them? Are there other characteristics or attributes that we have not yet considered?

We agree with the proposed characteristics and attributes of a future system operator.

Elxon does not have a preferred option in relation to the model of ownership of the proposed FSO. We are committed to work well with any of the proposed models. However, we believe that it is imperative that the FSO is, and is seen to be, independent from industry and from government. Consequently, we do have some concerns about the model of the FSO being a public body, which we list below.

Moreover, as a subsidiary of NG ESO, the existing independence and accountability of Elxon, which has been recognised as important and beneficial by BEIS/Ofgem in this consultation, must be preserved and constraints on Elxon's ability to manage its business, including the imposition of policies and procedures by government, avoided.

- We believe it is important that the FSO maintains independence not only from industry but also from government. This will be key to its credibility and effectiveness
- Elxon believes that if the FSO is to be an arm's-length public body it should have an independently appointed and managed board of directors and leadership team with clear accountability
- Given the number of expected changes and developments in the energy markets, we are concerned that being a public body could mean that the future FSO is subject to more bureaucracy, policy constraints, reviews etc. than necessary, which may ultimately lead to it being slow in its reaction to changes
- The FSO will need to be appropriately resourced and its management and employees effectively incentivised. This means for example the FSO should be free of government

constraints on remuneration otherwise it will be unable to compete with the private sector. Being some form of hybrid (i.e. independent yet constrained) organisation, will mean it will attract neither the best nor the altruistic.

Q.14 Are we considering the right organisation models for the FSO? And why?

Yes, in general the consultation considers the right organisational models, subject to the concerns outlined in questions 13.

Q.15 Are we considering the right elements for the FSO's regulatory and accountability frameworks? And why?

Yes, the consultation considers the right elements for the FSO's regulatory and accountability frameworks, namely:

Functions, powers and principal objective(s), Licence(s), Strategy and Policy Statement, Information sharing.

Q.17 Are we considering the right implications of our proposals for Elexon and Xoserve?

Elexon is a subsidiary of National Grid ESO and therefore Elexon is directly impacted by the proposed introduction of the Future System Operator. We believe that it is rightly recognised that Elexon's independence is of value to Government, Ofgem and the industry and should be maintained – we are pleased that this has been acknowledged by BEIS/Ofgem in the consultation and support maintaining such independence including from NG ESO as our parent and from whoever is the owner of NG ESO.

Furthermore, in Elexon's own case, it is clearly important that Elexon should not be distracted from delivering the Market-wide Half Hourly Settlement (MHHS) reform and the re-development of the industry central systems, which should deliver ~£4.6bn benefit to consumers – itself, a really important building block in the delivery of arrangements to support Net Zero.

Like Elexon we believe that Xoserve should also be considered in the Review, but would note that Xoserve is constituted differently, with their ownership residing with the Gas Transporters, of which National Grid is just one of 5.

Q.18 What is your view on the preferred implementation approach? Please explain why.

We agree with the implementation approach outlined in the consultation and support the two main elements:

- existing capabilities, where appropriate, will become the foundation of the FSO
- staggered introduction of additional functions of the FSO aiming to prioritise functions that will deliver the highest benefit to consumers and to net zero

Q.20 What do you believe are the risks to implementation? How can these be mitigated?

In addition to the considerations outlined in question 7 – which talks about implementation timelines for the on-going industry wide initiatives - another specific risk we highlight is that of resource availability. There are limited human resources who have the right skills, experience and knowledge needed to deliver change in the energy market. It will be important to retain existing resources and to ensure that initiatives are prioritised so that they can be delivered on time and in a manner that prioritises benefits to consumers and the market.

The risk around retaining resources is, in our view, a very real issue and it is therefore important that BEIS/Ofgem are clear of what it is that they are looking to deliver, when and by what means.

Also, we would like to see more clarity as early as possible on the overall FSO reform timeline, in particular an indicative start date to allow us, and the industry more generally, to plan resources and determine any potential risks to ongoing initiatives.

Q.21 Do you have any comments on potential implications of implementation for you, your organisation, or other stakeholders?

The potential implications for Elexon have been captured and discussed in question 17.