

24 August 2021

By e-mail to: HLIndustryRegulators@parliament.uk

Dear Industry and Regulators Committee Members,

Elexon 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.

Elexon 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.

Given our role in the energy market, we are subject to the regulatory regime overseen by Ofgem. We have been instrumental in ensuring the BSC and accompanying systems evolve to deliver net zero solutions and facilitate innovation in the energy market. We therefore recognise the importance of the Industry and Regulators Committee inquiry into Ofgem's role in achieving UK net zero targets and welcome the opportunity to share our comments, observations and suggestions. We do this from the perspective of having more than 20-years' experience of working alongside Ofgem, BEIS (and predecessors) and the energy industry.

In our response to the Committee's questions 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@elexon.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

**Question 1 - What role should Ofgem play in the transition to net zero?
What changes, if any, should be made to its remit, responsibilities and resources?**

- 1.1. We believe that Ofgem, as an economic regulator, has a key role in the energy industry transition to net zero along with BEIS, the industry and the companies who provide central market services and systems (the latter include, for example, in the electricity market Elexon and National Grid ESO and in the gas market National Grid Gas).
- 1.2. We believe that since the UK Government's commitment to net zero in 2019 Ofgem has responded effectively to the challenge with a range of measures for the markets that it regulates (gas and electricity). For example, in 2019 Ofgem created its Decarbonisation Action Plan, to ensure that it could support the Government targets. Ofgem also outlined that facilitating "decarbonisation efforts to deliver a net zero economy at the lowest costs to consumers" was one of its strategic objectives in its Strategic Narrative for 2019-2023 (published July 2019).
- 1.3. While from a strategic perspective Ofgem has responded to the net zero commitments in its strategic objectives, Ofgem has a number of "Applicable" and "Relevant" Objectives for the energy market codes, against which it must assess and justify its decisions. Presently there is no Objective in relation to net zero. We therefore believe that Objectives for the Codes, contained in the energy market Licences, need to be expanded to include references to the specific net zero commitment and targets.
- 1.4. Additionally, we believe that as new energy markets emerge, e.g. hydrogen, heat, etc. Ofgem will need to have an equal oversight and ability to extend its existing regulatory framework to these new markets to ensure there is a similar regulatory regime and oversight, given the potential interconnectivity. This would make it easier for market participants to operate across several energy market segments and foster new business models and services.
- 1.5. Electrification of transport presents another emerging market, with dependencies on the electricity market. We would therefore highlight that thought needs to be given to the regulatory environment in this regard and what, if any, role Ofgem should have.
- 1.6. In terms of new responsibilities, under the Codes Review (Details discussed under Q6) Ofgem and BEIS have proposed that Ofgem takes on new responsibilities, as a Strategic Body, providing strategic direction and driving change through the central market arrangements or codes.
- 1.7. Should the introduction of the Strategic Body become a role that Ofgem fulfils, and if there are other responsibilities that Ofgem picks up in relation to new energy markets, it will require Ofgem to have an adequate level of resourcing and skills in order to be effective. Given that the energy market and Ofgem are already managing many industry-wide initiatives and there is an impending skills shortage, any new role and/or responsibility for Ofgem will need careful consideration.

We note that Ofgem staff turnover appears to have been particularly high in recent years, and we believe this needs addressing to ensure continuity of strategic and operational thinking.

- 1.8. While the new responsibilities for Ofgem are being consulted on and put through the parliamentary approval process, we believe Ofgem must fully apply its existing powers to drive the changes that are needed for the energy industry to play its part in achieving net zero. These include but are not limited to active participation in code Panel meetings, code change workgroups and making timely decisions on code modifications.
- 1.9. To allow for a greater focus and agility in delivering Ofgem's suite of current and new core competencies and responsibilities, consideration may be given to outsourcing or giving up responsibility for some delivery functions such as E-serve, which administers green energy and social schemes on behalf of Government. We believe these services could be readily provided by existing, experienced service providers which would allow Ofgem to focus more clearly on its strategic activities.
- 1.10. Furthermore, we note that for the existing and any new roles, Ofgem, as any other organisation, will have to have clearly defined KPI (key performance indicators) and service standards. For example, in case of new policies or a strategic direction for the industry, any set deadlines need to be observed and adhered to, as any delay of Ofgem's decision making process has a cascade effect on industry's implementation plans.

Question 2 - How well does Ofgem balance environmental objectives against its responsibilities in relation to affordability for consumers?

- 1.11. Ofgem has a commitment to protect present and future consumers and to help the transition to net zero. However there will need to be investment in new technologies, infrastructure and markets to deliver net zero, which therefore puts Ofgem in a difficult position in trying to balance the two objectives that they have been set – environmental and affordability. We would therefore suggest that Ofgem needs to maintain transparency of its decision-making by publishing cost-benefit assessments for its decisions. At the same time it may be prudent if Ofgem were to either develop or be provided with guidance as to what is expected of them in making decisions, which by their nature may be contradictory between the objectives. Additionally, we believe where Ofgem's views differ from those of government the differences should be shared in a more transparent manner.

Question 6 - Is the current system of governance for the UK energy market appropriate to secure the transition to net zero? What improvements could be made and what role should Ofgem play?

- 1.12. At present, the energy market in the UK is governed through licences and also a number of codes. The codes are commercial multiparty agreements between the industry participants and as such include modification processes, which bring industry participants together to develop the changes to ensure that new ways of working and innovation can be developed and introduced transparently. Part of this system is self-governance, where a change which is not significant can be

approved by the appropriate code Panel of industry experts. However, all significant code modifications go to Ofgem (more specifically, GEMA) for approval. As such, Ofgem (GEMA) as an independent decision making body, considers the Code Panels' recommendations on the changes and take these into account but, ultimately, makes its own decisions, by considering the Applicable or Relevant Objective to the relevant code. Where GEMA makes a decision that does not accord with the Panel recommendation, that decision can be appealed by any Party to the Code to the Competition and Markets Authority, under the Energy Act Appeal mechanism.

- 1.13. This system of industry governance has been subject to a number of reviews, including through the CMA investigation into the energy market in 2016, and more recently through the BEIS/Ofgem Energy Codes Review in 2019.
- 1.14. The Energy Codes Review is focused on achieving four main objectives:
- Providing strategic direction
 - Empowered and accountable code management
 - Independent decision making
 - Code simplification and consolidation
- 1.15. We strongly believe that certain areas of the Energy Codes Reform need to be prioritised. We believe that code consolidation and simplification is the most important area of the Energy Codes reform. Elexon believes that code consolidation and simplification needs to be the first practical step to achieve BEIS/Ofgem's objectives referred to above and that Ofgem already has existing powers to work with industry and the Code bodies to achieve code consolidation and simplification.
- 1.16. We believe the Codes Review could identify 'no-regret' options for the consolidation of code management functions and that this could be implemented relatively expediently as a first step. Once this first step is agreed and has been implemented, further consolidation options could be proposed and assessed in parallel.
- 1.17. From the start of the Energy Codes reform in 2019, Elexon has been heavily engaged with the industry, Ofgem and BEIS to identify and define options for code consolidation and proposed several options. Please see our detailed suggestions at the links below:
- Reforming the System Operator Roles and the Code Arrangements (Feb 2021) <https://www.elexon.co.uk/documents/industry-insights/cornwall-insight-study-for-elexon-on-options-for-reforming-the-energy-codes/>
 - A faster, more consistent process for changing energy codes (July 2020) <https://www.elexon.co.uk/documents/elexon-policy-view-a-faster-more-consistent-process-for-changing-energy-codes-july-2020/>

- Cornwall Insight Code Consolidation Insight Study (July 2019)
<https://www.elexon.co.uk/documents/industry-insights/cornwall-insight-study-for-elexon-on-options-for-reforming-the-energy-codes/>
- Elexon Policy View: The Energy Codes Reform (May 2019)
<https://www.elexon.co.uk/wp-content/uploads/2019/05/Elexon-Policy-View-on-Energy-Codes-Review-May2019.pdf>

1.18. We also would like to point out that there is a wide range of models and practices among codes bodies e.g. for profit and not for profit, price controlled and non-price controlled, licensed and not licensed. We strongly believe that best practices need be identified between these models and consistently applied across all codes as a first practical step. Ideally this should be done by considering what behaviours Ofgem wishes to see and which of the current arrangements/models are driving those behaviours. We believe addressing the disparate arrangements (which have simply evolved over time) is achievable and would result in real and tangible benefits for the existing and new industry participants, as well as helping the energy industry advance on its way to achieve net zero. We further believe that there is a real opportunity to drive down the overhead costs through consolidation e.g. corporate services and offices, as well as reduce the costs of participants' interactions with the code bodies, to reduce the overall cost of the arrangements to the consumer.

Question 8 - Is Ofgem's relationship to Government and Parliament appropriate? Are there issues related to the split of responsibilities, transparency or accountability

1.19. Overall, we believe that the relationship as defined by the statutory framework set by Parliament is appropriate.