# Market Facilitator Workshop 2 Digital Meeting Etiquette

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- We encourage attendees to **use video**, where bandwidth allows, especially if talking
- **Mute when not speaking**:
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  - use Teams chat if you can't break through
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- Respect all perspectives: Foster a collaborative and inclusive environment
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**Market Facilitator – Enduring Governance Arrangements**

Budgeting and Finance

Stakeholder Workshop #2

18 December 2024

# Agenda & Objectives

| Item | Lead |
|---|---|
| Introductions and objectives | Lawrence Jones |
| Cost Recovery Model | Iain Nicoll |
| Budget Setting Process | Lawrence |
| Finance Processes | Lawrence |
| Close and next steps | Lawrence |

**Objectives**

1. Agree who should fund the Market Facilitator and how the costs should be apportioned
2. Agree the Market Facilitator budget setting process
3. Agree the financial processes, including billing cycles, reconciliation and mutualisation

# COST RECOVERY MODEL

What class(es) of party should fund the market facilitator, and how should costs be apportioned between them?

# Who should fund the Market Facilitator (MF)? – Introduction (1 of 3)

- Ofgem's preferred position is that the MF will set its own budget ahead of year
- The budget will largely be driven by the Delivery Plan, which Ofgem also propose that the MF sets itself (and will be the dsubject of the next workshop on 23 Jan 25)
- However, the MF will design the detailed funding arrangements [which form the focus of this topic]
- As with all the MF detailed design, we will submit our final budgeting and finance proposals to Ofgem for approval, following industry consultation

- In developing these proposals, we have been cognizant of Ofgem's governance outcomes for the MF:
  - Accountable
  - Efficient
  - Delivery at pace
  - Inclusive and collaborative
  - Transparent
  - Trusted

- Ofgem published the Market Facilitator policy framework consultation on 10 December 2024 (closes 11 February 2025)

- There are policy proposals on the budget and appeal processes, input of a Stakeholder Advisory Board and links to the Delivery Plan that are relevant to this workshop


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# Who should fund the Market Facilitator (MF)? – Introduction (2 of 3)

- Elexon operates all of its services on a not-for-profit basis
  - This will also be the case for the MF

- Transitional MF costs relate to the development and implementation of the MF arrangements
  - These are being treated as BSC Costs, recovered from BSC Trading Parties based on market share, as per P481 'Extend Elexon's role and responsibilities to be the Market Facilitator Delivery Body'
- Enduring MF costs will relate to the operation and evolution of the governance and technical arrangements, plus any changes to the scope of MF services e.g. FMAR
  - One of the aims for this workshop is to propose and agree who and how to fund the MF costs on an enduring basis

- We are inviting industry comment on our 2025/2026 business plan week commencing 16 December 2024. Therefore, these numbers are still provisional and subject to Elexon board approval
  - We have budgeted £1.6 million for MF activities in 25/26

# Who should fund the Market Facilitator (MF)? – Introduction (3 of 3)

**What additional services does Elexon recover costs for now (as prescribed within the BSC) and how is it done?**

| Role | Cost Recovery | Size of service provided |
|---|---|---|
| Capacity Market Advisor Group (CMAG) | Treated as BSC Costs and therefore funded by BSC Trading Parties | Small |
| Energy Price Guarantee (EPG) | Treated as BSC Costs and therefore funded by BSC Trading Parties | Small |
| Data Integration Platform (DIP) Manager | Core services funded by Suppliers based on market share based on MPAN count | Medium |
| Market Wide Half Hourly Settlement (MHHS) | Funded by Suppliers based on MPAN count specified charge (£/MPAN) | Large |
| Market Facilitator | Implementation period - treated as BSC Costs, therefore funded by BSC Trading Parties<br><br>Operational period – subject to MF detailed design | Small<br><br>Medium |

- Radio Teleswitch Service (RTS) costs were passed from DNOs to Suppliers. It was a more efficient process for costs to be recovered directly from Suppliers via the BSC – RTS used by Suppliers to control RTS tariffs, but service is considered as an SVA Cost that is paid for by Suppliers/Generators (50/50)
  - Suppliers pay a SVA Specified Charge, which is a fixed price per SVA Metering System per month
  - Generators calculated as a funding share based on CVA volumes
  - Recent budgeted pass through costs have been £4-5mil
  - Designed for interim period, until end of RTS (originally from 2019 to 2021 but extended to 2025)

# Who should fund the Market Facilitator (MF)? – Assessment Criteria

- To support the assessment of who should fund the MF and how, we have developed some assessment criteria

| Criteria | | Description |
|---|---|---|
| 1. Cost causation | Who | Those who use the service, benefit from or drive the need for the MF role should bear the costs |
| 2. Fairness | How | The funding mechanism should distribute costs equitably, avoiding undue burdens and acting as a barrier to entry |
| 3. Simplicity and Transparency | How | The funding approach should be straightforward to administer and transparent to all stakeholders |
| 4. Predictability and Stability | How | Funding mechanisms should avoid sudden changes that could disrupt market participants |
| 5. Administrative Efficiency | How | The solution should be proportionate, not cost more to implement and operate than the costs being recovered |

- Additionally, we believe it is important to remember that whoever funds the MF, it is ultimately consumers that pay

- Do you agree with these criteria?
- Are there any other criteria you think we should be considering?

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# Do you agree with these criteria?

# Are there any other criteria you think we should be considering?

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# Who should fund the Market Facilitator (MF)? - Options

- We have identified three classes of party that we believe are most appropriate to fund the MF
- We ruled out Flexibility Service Providers funding the MF as we believe this would act as a significant barrier to entry, especially when local flex markets are not yet mature

**System Operators**: as these will be the primary users of the service and are driving the need for the MF

- **DSOs and NESO** – makes sense in principle, but it impacts both DUoS and BSUoS arrangements, and doesn't have any advantage to consumers (compared to a NESO-only option)
- **NESO only** – most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS
    - Most flexibility is procured by NESO
- ~~**DSOs only** - We have ruled out DSOs only as most flexibility is procured by NESO~~

**Suppliers** – as ultimately any costs borne by other classes of party will be passed back to Suppliers, but there may be impacts on the Price Cap

**BSC Trading Parties** – as this would be the lowest cost to implement and operate and is a proportionate solution for the sums to be recovered

- Are there any other classes of party you think we should be considering to fund the MF?
- Any comments on the rational or additional rational for justifying who should fund the MF?



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**Are there any other classes of party you think we should be considering to fund the MF?**

**Any comments on the rational or additional rational for justifying who should fund the MF?**

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## Where should the funding arrangements be implemented?

- All the classes of party that we have identified are also BSC Parties
- We therefore believe the funding arrangements (whoever it is) should be implemented in the BSC as:
  - It will put legally binding obligations on the relevant parties to fund the MF arrangements;
  - It opens up the option to use the existing BSC mechanisms in relation to non-payment, mutualisation, default and escalation;
  - The BSC Modifications Procedures can be used to amend the arrangements, if needed, by the funding parties
  - It will allow us to consider using existing BSC finance processes and systems, reducing costs to implement and operate
    - For example, we can avoid building new invoicing systems and processes and implementing new mutualisation processes
  - It will best align with Ofgem's policy proposal that 'costs should not be demonstrably uneconomical, wasteful or inefficient', particularly in relation to administrative processes to fund the MF role

- Alternatively, we could implement the cost-recovery, budgeting and finance rules and processes in new MF documents
  - Under existing Ofgem policy, only DSOs and NESO will be bound by this
  - We have not identified any benefits that cannot be realised by including the funding arraignments in the BSC and therefore do not believe the additional cost of implementing and operating funding arrangements in new standalone MF documents can be justified
  - If NESO only option, it could be more efficient to include in MF documents (outside BSC)
  - Would de-risk the uncertainty from the Energy Code Reform proposals on Code Manager budgets and delivery plans
  - Would make the arrangements less ‘tangled’ with the BSC and therefore easier to port

- For all the reasons on this slide we propose that the cost-recovery, budgeting and finance rules should be implemented into the BSC, via a BSC Modification

Do you agree that the cost-recovery, budgeting and finance rules and processes should be implemented into the BSC? (and not standalone MF documents) and why

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## Do you agree that the cost-recovery, budgeting and finance rules and processes should be implemented into the BSC (and not standalone MF documents) and why

ⓘ Start presenting to display the poll results on this slide.

## What is the impact on the DSO price control?

- DNOs are subject to network Price Control
  - Implemented under Ofgem's RIIO (Revenue = Incentives + Innovation + Outputs) model
  - Current version is RIIO-ED2 which runs from 2023-2028
  - Sets the output DNOs need to deliver for their consumers and the associated revenues they are allowed to collect for in the period
  - Provides the framework for the Business Plan that DNOs submit to Ofgem
  - Ofgem currently consulting on RIIO-ED3 for the next period

1. If DNOs/DSOs impacted by cost recovery for Market Facilitator costs what impact would that have on the DNOs Business Plan?

2. Would they pass costs on (e.g. to Suppliers) or absorb them? Possible impacts with Supplier Price Cap

3. How would Market Facilitator outputs impact the Business Plan (e.g. if it involved IT systems changes/development)?

- We are currently assuming that DSOs would be able to pass through MF costs and recover them via DUoS

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**If DNOs/DSOs impacted by cost recovery for Market Facilitator costs what impact would that have on the DNOs Business Plan?**

**Would they pass costs on (e.g. to Suppliers) or absorb them? Possible impacts with Supplier Price Cap**

**How would Market Facilitator outputs impact the Business Plan (e.g. if it involved IT systems changes/development)?**

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# What is the impact on the NESO price control?

- NESO operates a not-for-profit model, is licensed and regulated by Ofgem and is funded through electricity and gas industry charges

- NESO is a publicly owned organisation

- The regulatory model to recover NESO internal expenditure operates on a ‘100% fast money’ approach. This means NESO can seek to recover its full forecast spend within the financial year, with subsequent true ups to account for differences between revenue collected from industry parties and actual spend

- NESO has a Financial Model which contains detailed calculations for its allowed revenue terms
  - This includes Balancing Service Use of System (BSUoS) charges

- The allowed revenue model has four components, two of which covers external costs (EXT) and internal costs (INT) –
  - EXT - third party charges incurred in balancing the system - is included in BSUoS tariffs based on the latest forecast available at the time the tariff is set. Although not determined by the Financial Model, the level of costs incurred for EXT is populated into the model once actual costs are known
  - INT - the operating cost of the business applicable to electricity activities, recovered via BSUoS charges

- Would MF costs be covered under BSUoS Tariff?
  - An Internal NESO Cost (allowed revenue) which is calculated in the Price Control Financial Model (PCFM) process determined by the current RIIO-T2 price control period (2021-2026).

- Would the costs be passed on to Suppliers (Final Demand) via that mechanism?

- We are currently assuming that NESO would be able to pass through MF costs and recover them via BSUoS

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# Do you agree with this analysis and are there any other impacts we should be aware of for NESO?

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# What is the impact on the Supplier price cap? (1 of 2)

- Currently, BSC costs (and some other central body costs) are treated as pass though costs within the operating cost allowance component of the price cap
  - Ofgem have standardised this cost across Suppliers

- Elexon's costs within the operating cost allowance are currently updated using an indexing method and do not take into account the most recent BSC budget

- Elexon’s costs have increased by more than inflation (as have other code bodies included in the price cap)
- Based on 23/24 data the cost is now £0.79 per electricity customer, compared with the indexed price of £0.29 per electricity customer
- Ofgem note “…that this is relatively low materiality – the latest difference of £0.51 per electricity customer is approximately 0.41% of the operating cost allowance per electricity customer.”
- These cost increases are due to the expansion of responsibilities linked to the introduction of MHHS
- MHHS is several magnitudes larger than the Market Facilitator, so MF should have a minimal impact on Suppliers

- Ofgem are currently reviewing the operating cost allowance as it is largely driven by 2017 data
  - One option they are considering is to set pass-through industry charges as a separate allowance based on industry body charging statements rather than incorporating these costs into the core operating cost element of the allowance and doing so more regularly

# What is the impact on the Supplier price cap? (2 of 2)

- Therefore, if Suppliers or BSC Trading Parties (which includes Suppliers) are required to fund the MF arrangements under the BSC, these costs will be passed to Suppliers but may not be accounted for in the Price Cap operating cost allowance (as current process based on indexation and does not allow for the latest BSC budgets)
- However, this should not have material impact. Furthermore, Ofgem may revise this method so that the price cap does allow for more up to date budgets

- We are currently assuming that Suppliers will be able to partially recover MF costs from consumers if invoiced directly and fully if charged via increased BSUoS or DSUoS charges

- Do you agree with this analysis and are there any other impacts we should be aware of for Suppliers?

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# Do you agree with this analysis and are there any other impacts we should be aware of for Suppliers?

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# Apportionment options summary

**Seven options under consideration**

**Option 1 – Suppliers by Funding Share based on MPAN count**

**Option 2 – Suppliers via a Specified Charge (£ / MPAN)**

**Option 3 – Supplier from Funding Share based on Volumes (MWh)**

**Option 4 – NESO and DSOs apportioned based on NESO/DSO split – fixed NESO % and fixed DNO areas based on licensed area**

**Option 5 – NESO and DSOs apportioned based on NESO/DSO split – fixed NESO % and DNO areas based on MPAN count**

**Option 6 – Fixed cost on NESO**

**Option 7 – By spreading the cost across BSC Trading Parties – treat as BSC Costs**

- **We are proposing for all options that the amounts are calculated and invoiced monthly**

**Each option will be presented and discussed with a view to removing options from further discussion and identifying a preferred option or shortlist of options**



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# How could funds be recovered? - Suppliers

**Option 1 – By Funding Share based on MPANs (calculated monthly)**

- Linked to number of MPANs – **identifies Supplier proportions e.g. Supplier 'X' has Y number of MPANs and total number of MPANs is Z, therefore % Funding Share for Supplier 'X' = (Y / Z) x 100**
- Adjustments to forecast are handled immediately, in the case of reductions, monies returned instantly
- Faster reconciliation
- More system development required
- Similar to how RECCo and DIP recover their costs

**Option 2 – Via a Specified Charge (calculated monthly)**

- Fixed unit charge per MPAN – **identifies Supplier proportions e.g. budgeted costs divided by total number of MPANs gives a £ / MPAN cost, therefore for Supplier 'X' = (£ / MPAN) x Number of MPANs for Supplier 'X'**
- Will require a relatively small change to systems
- More cost certainty
- May require multiple changes to rates during the year as forecasts change
- Slower to return any underspend/recover additional costs
- Similar to MHHS Charges

**Option 3 – Funding Share based on Volumes (MWh) (calculated monthly)**

- Supplier Funding Share based on MWh volumes – **identifies Supplier proportions e.g. Supplier 'X' accounts for Y MWh and total MWh across Suppliers is 'Z', therefore % Funding Share for Supplier 'X' = (Y / Z) x 100**
- Adjustments to forecast are handled immediately, in the case of reductions, monies returned instantly
- More system development required
- Faster reconciliation
- More volatile than using MPAN counts and harder to forecast
- Volumes can change quite significantly month on month, making it harder to predict cashflow requirements

## Cost Recovery Process – Supplier Only Options 1 and 3

Supplier only (Funding Share based on MPAN count or MWh volumes)

1. MF Costs predicted and included in Business Plan[1] for consultation
2. MF Costs split amongst funding parties[2] (e.g. £1mil)
3. Supplier Funding Share calculated (MPAN or MWh) (e.g. if 20% Funding Share = £200k)
4. Monthly MF Costs – (e.g. if 20% Funding Share £200k / 12 = £ £16.67k per month)
5. BSSCo conducts reconciliation each month as per BSC Section D

[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?
[2] For discussion – who are the funding parties? e.g. only Suppliers



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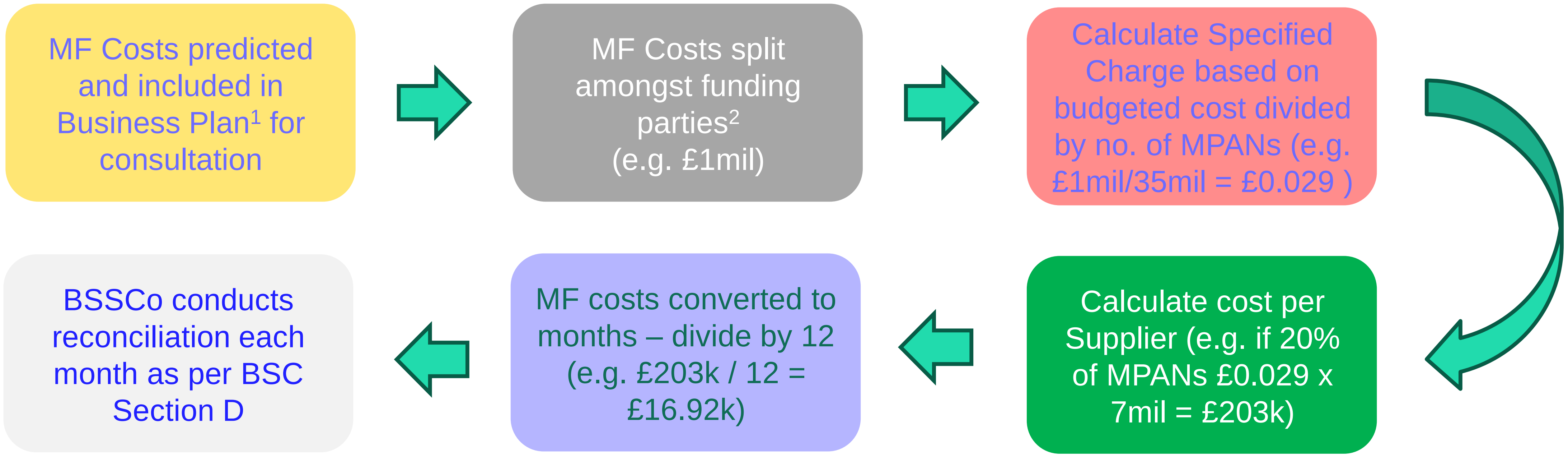
# Cost Recovery Process – Supplier Only Option 2

Supplier only (Specified Charge)




[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?
[2] For discussion – who are the funding parties? e.g. only Suppliers



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**Do you agree with these apportionment options for Suppliers?**

**Are there any other apportionment options you think we should be considering for Suppliers?**

**What are the advantages / disadvantages of Suppliers funding the MF?**

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# How could funds be recovered? - NESO and DSOs (not IDNOs)

**Option 4 – Apportioned based on NESO/DSO split (DNO areas – Fixed)**

- NESO operate GB wide, larger user of ancillary services – fixed apportionment value e.g. 50% of costs
  - This could be changed from time to time, subject to consultation and Ofgem appeal
- DSO contribution based on fourteen licensed geographical areas
- Fixed 1/14th for each area a DSO responsible for
- Takes no account on variations in size and number of connections (MPANs)
- Process needed to be developed for cost recovery / non-payment / default etc, if we don't hook into Section D/H processes
- Good cost certainty, simple and transparent
- Low costs to implement and operate
- Annual reconciliation
- Would costs be passed through to Suppliers (then customers)?

**Option 5 – Apportioned based on NESO/DSO split (DNO areas – MPANs (calculated monthly))**

- NESO operate GB wide, larger user of ancillary services – fixed apportionment value e.g. 50% of costs
  - This could be changed from time to time, subject to consultation and Ofgem appeal
- MPANs issued for each area used as basis for apportionment – process required to determine MPAN counts and update on an ongoing basis
- Dependency on DNO MPAN counts being received, risk this may be after the fact which risks monthly settlement being delayed getting the data in, causing a funding shortfall
- May be an MHHS dependency on GSP Group Id being available at MPAN level
- Process needed to be developed for cost recovery / non-payment / default etc, if we don't hook into Section D/H processes
- Increased complexity and therefore costs to implement and operate from option 4
- Cost certainty
- More reflective of DSO customer size
- Annual reconciliation
- Would costs be passed through to Suppliers (then customers)?

# Cost Recovery Process – NESO and DSOs Option 4

Fixed costs only – NESO and DSO only (based on area or number of Licences)

MF Costs predicted and included in Business Plan[1] for consultation

MF governance[2] determine % for MF Costs NESO responsible for (e.g. 50% of £1mil = £500k)

NESO MF Costs converted to months – divide by 12 (e.g. £500k / 12 = £41.67k)

BSSCo conducts annual reconciliation

MF governance[2] determine % for DSO MF Costs (e.g. 50% of £1mil = £500k)

DSO MF Costs converted to months – divide by 12 (e.g. £500k / 12 = £41.67k)

MF Costs divided by number of DSO (per area or Licences) funding parties (e.g. £41.67k / 14 = £2.98k)

MF Costs multiplied by number of DSO areas or Licences (e.g. £2.98k x 3 = £8.94k)

BSSCo conducts annual reconciliation

[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?
[2] For discussion – what is the governance body that makes the determination?

# Cost Recovery Process – NESO and DSOs Option 5

Fixed costs only – NESO and variable costs DSO only (based on MPAN share)

MF Costs predicted and included in Business Plan[1] for consultation

MF governance[2] determine % for MF Costs NESO responsible for (e.g. 50% of £1mil = £500k)

NESO MF Costs converted to months – divide by 12 (e.g. £500k / 12 = £41.67k)

BSSCo conducts annual reconciliation

MF governance[2] determine % for DSO MF Costs (e.g. 50% of £1mil = £500k)

Monthly costs calculated per DSO and proportion of number of SVA Metering Systems – (e.g. DSO ‘X’ has Registrant for 15% of SVA Metering Systems in GSP Group – 15% of £1mil per month would be is £12.5k)

BSSCo conducts monthly/annual reconciliation

[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?

[2] For discussion – what is the governance body that makes the determination?

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**Do you agree with these apportionment options for NESO and DSOs ?**

**Are there any other apportionment options you think we should be considering for NESO and DSOs ?**

**What are the advantages / disadvantages of NESO and DSOs funding the MF?**

ⓘ Start presenting to display the poll results on this slide.

# How could funds be recovered? – NESO only

## Option 6 – Fixed cost on NESO

- We understand NESO would recover these costs via BSUoS
  - most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS
- NESO operate GB wide, larger user of ancillary services
- NESO have a dominant role in the market and are critical to the success of flexibility markets
- Significantly larger than DSO flexibility services
- Process needed to be developed for cost recovery / non-payment / default etc, if we don't hook into Section D/H processes
- Good cost certainty and predictability
- Transparent and simple
- Annual reconciliation
- NESO will be entirely funded by consumers who will ultimately pay



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## Cost Recovery Process – NESO Option 6

Fixed costs only – NESO

MF Costs predicted and included in Business Plan[1] for consultation

→ MF governance[2] determine NESO responsible for MF Costs NESO responsible for (e.g. £1mil)

→ NESO MF Costs converted to months – divide by 12 (e.g. £1mil / 12 = £83.33k)

→ BSSCo conducts annual reconciliation

[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?

[2] For discussion – what is the governance body that makes the determination?

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**Do you agree with this apportionment option for NESO?**

**Are there any other apportionment options you think we should be considering for NESO?**

**What are the advantages / disadvantages of NESO funding the MF?**

ⓘ Start presenting to display the poll results on this slide.

# How could funds be recovered? – BSC Trading Parties

**Option 7 – By spreading the cost across BSC Parties (Trading Parties)**

- Use existing Section D process to apportion MF costs
- No system development required
- Includes Suppliers and Generators
- This is how MF costs are being recovered during the implementation period
- Current BSCCo processes for cost recovery / non-payment / default / escalation

# Cost Recovery Process – BSC Trading Parties (all) Option 7

As a BSC Cost for all BSC Trading Parties

MF Costs predicted and included in Business Plan[1] for consultation

→

MF Costs split across BSC Trading Parties per month
(e.g. if Party 'X' is responsible for 5% of BSC Costs (£1mil x 5%) / 12 = £4.167k)

→

BSSCo conducts monthly reconciliation

Do you agree with these apportionment options?

Are there any other apportionment options you think we should be considering?

What are the advantages / disadvantages of each option?

[1] For discussion – can it be included in BSC Business Plan? How aligned does it need to be with Delivery Plan window (e.g. Jan-Dec or Apr-Mar)?

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**Do you agree with this apportionment option for BSC Trading Parties?**

**Are there any other apportionment options you think we should be considering for BSC Trading Parties?**

**What are the advantages / disadvantages of BSC Trading Parties funding the MF?**

ⓘ Start presenting to display the poll results on this slide.

# Assessment

| Criteria | Criteria Description | Assessment |
| --- | --- | --- |
| 1. Cost causation | Those who use the service, benefit from or drive the need for the MF role should bear the costs | • DSOs and NESO will be the primary users and beneficiaries of the service and have driven the need for the MF. Most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS. |
| 2. Fairness | The funding mechanism should distribute costs equitably, avoiding undue burdens and acting as a barrier to entry | • The apportionment options that are based on market share avoid overburdening smaller participants. We recognise that  market share may not reflect the true drivers of the cost, but we do not believe reliable data is available for this. Further, we do not believe this would be a proportionate solution to the costs being apportioned as it would be much more complex (costly) to implement and operate.<br>• Most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS<br>• The non-market share options, could be seen as unfair, as they are approximations for size |
| 3. Simplicity and Transparency | The funding approach should be straightforward to administer and transparent to all stakeholders | • Market share is a straightforward metric, making the mechanism easier to calculate and communicate.<br>• The simplest option is to recover costs from NESO, or split costs with DSOs by 14 regions. |
| 4. Predictability and Stability | Funding mechanisms should avoid sudden changes that could disrupt market participants | • Options including energy volumes are more volatile and harder to forecast than MPAN counts. The most predicable and stable option is the NESO option, followed by the fixed NESO proportion and DSO split by region. |
| 5. Administrative Efficiency | The solution should be proportionate, not cost more to implement and operate than the costs being recovered | • The most efficient solution to implement and operate is to treat MF costs as BSC Costs and recover from BSC Trading Parties, followed closely by NESO only and then NESO/DSOs based on fixed apportionment. The least efficient would be the DSO split by MPAN as this would be based on a methodology we have not implemented before. |

## How could funds be recovered? – Can we rule any out?

We have ruled out the following:

**DSOs and NESO** – makes sense in principle, but it impacts both DUoS and BSUoS arrangements and doesn't have any advantage to consumers (compared to a NESO-only option). It would be more complex to implement and operate.

**Suppliers** – as ultimately any costs borne by other classes of party will be passed back to Suppliers, but may not be the most efficient vs NESO (invoice one party vs multiple) and may impact Price Cap

**BSC Trading Parties** – Whilst this would be the lowest cost to implement and operate it would place costs on large generators who are not users of flex

# What is the preferred option?

- **NESO Option 6** is the preferred option

**<u>Option  6 – Fixed cost on NESO</u>**

- Recover annual amount from NESO spread across 12 months
- Process needed to be developed for cost recovery / non-payment / default etc, if we don’t hook into Section D/H processes
- Good cost certainty and predictability
- Transparent and simple
- Los cost to implement and operate – no system changes needed
- Reduces impact on Suppliers, as costs would pass through existing BSUoS mechanisms and included in Price Cap calculation
- Annual reconciliation
- NESO will be entirely funded by consumers who will ultimately pay

**<u>Justification</u>**

- We understand NESO would recover these costs via BSUoS
  - most of the markets we’ll be facilitating (measured by volume) are ancillary services funded through BSUoS
- NESO operate GB wide, larger user of ancillary services
- NESO have a dominant role in the market and are critical to the success of flexibility markets
- Significantly larger than DSO flexibility services

Do you agree that NESO should fund the MF?

Do you agree with option 6 as the preferred option?

## Preferred Option Assessment against criteria

| Criteria | | Description | Assessment for NESO |
|---|---|---|---|
| 1. Cost causation | Who | Those who use the service, benefit from or drive the need for the MF role should bear the costs | NESO will be the primary users and beneficiaries of the service and have driven the need for the MF. Most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS. |
| 2. Fairness | How | The funding mechanism should distribute costs equitably, avoiding undue burdens and acting as a barrier to entry | We believe these are due burdens for the reasons given above and will not act as a barrier to entry as costs will be recovered via BSUoS |
| 3. Simplicity and Transparency | How | The funding approach should be straightforward to administer and transparent to all stakeholders | This is the simplest option as annual amount recovered from single entity |
| 4. Predictability and Stability | How | Funding mechanisms should avoid sudden changes that could disrupt market participants | This is the most stable and predictable option as the amount is fixed each month |
| 5. Administrative Efficiency | How | The solution should be proportionate, not cost more to implement and operate than the costs being recovered | This option will not require any system changes as it can be processed manually in existing finance systems |

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**Do you agree that NESO should fund the MF and why?**

**Do you agree with option 6 as the preferred option and why?**

ⓘ Start presenting to display the poll results on this slide.

# BUDGET SETTING PROCESS

# Introduction

Ofgem's preferred model is the MF setting its own budget (with stakeholders scrutinising the draft budget)

How would this work in detail:

- Is the process linked to (or separate from) the existing BSC budget-setting process?
- Is there involvement from a Stakeholder Advisory Board (SAB)?
  - Ofgem consultation proposes the SAB provides external input to Elexon on areas like budget development
- How is the budget approved (e.g. role of Elexon Board)?
  - Ofgem consultation proposes consultation on the draft budget; and
  - Final budget subject to an appeals process
- Checks and balances (to ensure stakeholder concerns are addressed)
  - Consultation on draft budget
  - SAB input
  - Appeals process

# Ofgem Market Facilitator Policy Framework (1)

Budget setting and scrutiny proposal

Proposal is for the MF to set its own budget ahead of year and that the process is subject to the following requirements:

- Budgets are cost reflective;
- Costs included should be set out in a clear and transparent manner;
- Costs should not be demonstrably uneconomical, wasteful or inefficient;
- Publish a draft budget ahead of the relevant year for a set consultation period and invite comments from stakeholders. Consultation responses must then be considered and responded to, as part of finalising the budget; and
- The final budget is subject to an appeals process, enabling stakeholders to dispute the final budget subject to an agreed process and specific criteria.

Linked to the Delivery Plan proposals -

- Two-year Delivery Plan published (consulted on)
- One year Delivery Schedule (more granular detail than Delivery Plan)

# Ofgem Market Facilitator Policy Framework (2)

Appeals process proposals could include:

- A clearly set out appeals process in the governance arrangements, including setting a time window for appeals (e.g. 10 working days after publication of the relevant technical output or budget)
- A set of criteria for valid appeal grounds, including a provision for Ofgem to reject appeals that do not meet the grounds or that are vexatious or trivial
- Clear criteria on who can submit an appeal to limit the potential for abuse.

Focusing on budgets, this could include for example:

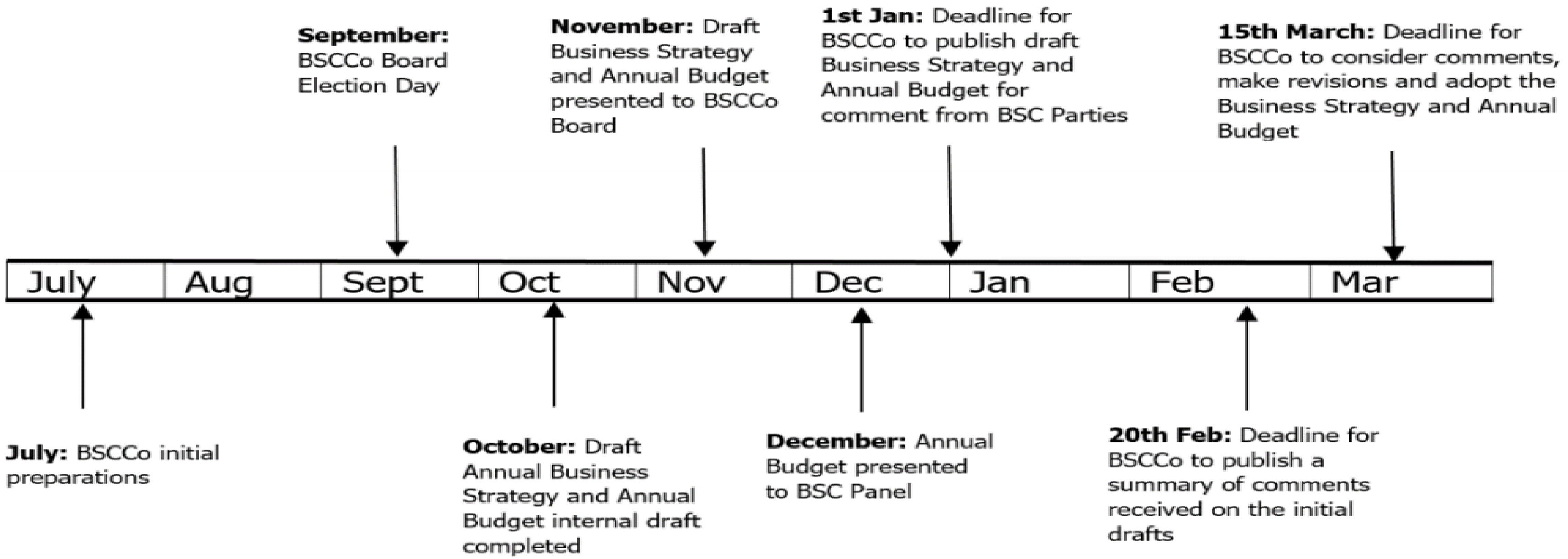
- That appeals do not stop the budget being spent while the appeal is in progress
- That an appeal should relate to a specific budget item
- That Ofgem should not be required to specify a new value for budget amounts

# BSC Business Plan and Budget Setting Process (1 of 2)

- The BSC requires Elexon to prepare a business strategy setting out the principal activities which it expects to be carrying out in the coming financial year (the Plan Year) and each of the two following financial years
- The BSC also requires Elexon to prepare an annual budget setting out the expenditure reasonably necessary in order to carry out the business strategy in the Plan Year
  - Elexon produces budgets for each of the three years

- The budget focuses on the on-going business as usual expenditure to deliver BSC and EMR obligations, including people costs based on the current structure, BAU Operational, Demand Led, System Strategy, and Contracted costs based on current contracts. The EMR budget is managed separately.

- In line with corporate governance best practice, the BSCCo Board is solely responsible for setting the BSCCo business strategy and budget, but is required to seek views from the BSC Panel and from industry



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# BSC Business Plan and Budget Setting Process ( 2 of 2)

**Can the BSC budget be appealed?**

- No – and Ofgem recently rejected a proposal to include an appeal mechanism (see P416 Introducing a route of appeal for the Annual Budget in line with the proposals for the Retail Energy Code)
  - "The ability for BSC Parties to vote on Non-Binding Resolutions provides a direct route for Parties to raise BSC related matters with the Board. In approving P324, we set out an expectation that, while the outcome of such a vote is not binding, the ability for BSC Parties to seek the removal of Directors from the Board via a Binding Resolution would ensure that non-binding resolutions would carry appropriate weight with the Board. We do not consider that sufficient evidence has been presented to demonstrate that these mechanisms are either inefficient or disproportionate for challenging the budget as, since being introduced, we are unaware of any instance in which they have been used for this purpose. "

- However, should Parties believe that the budget is inappropriate or that their comments have not been sufficiently addressed they can raise Voting Party Resolutions

- Parties can remove any Director [of the Board] through a binding resolution (meaning the Board would have to abide by the outcome of the vote)
- Parties also have the right to raise and vote on resolutions on other issues which would be non-binding (but which may lead to further binding resolutions to remove Directors)
- Such proposals (both binding and non-binding) can be put forward by a Voting Party or group of Voting Parties with a combined share of 5% or more of the total votes allocated across all the relevant Voting Parties.
  - NESO, Suppliers, generators and DSOs are Voting Parties under the BSC (see C-2 2.1.1)

- For binding resolutions: Authorised Person from one or more Voting Parties (with >5% share) notify BSCCo of resolution with rationale → BSCCo send voting form to Voting Parties → General Meeting arranged → voting takes place via proxy or at General Meeting → BSCCo publish result

# BSC Board Constitution

- The members of the Board have a strong mix of multi-disciplinary experience and a composition that follows corporate governance best practice. The Elexon Board is ultimately accountable to BSC Parties.
- The board delegate to the Chief Executive authority to conduct the day-to-day business of BSCCo

- The size and composition of the Board is determined by the Board's Nomination Committee, but must adhere to:
  - Majority of directors must have electricity experience
  - The board can not have more than two directors from BSCCo – currently CEO is appointed a Director
  - Must have at least two independent directors
  - Panel chair can also be BSCCo chair – currently this is the case

- Directors are subject to an 'Appointment Resolution' at the Annual BSC Meeting

- Note that our recent change in ownership (from ESO to 13 Parties with >2% market share) had no impact on our operations
  - Transitioned to 'federated mode' ownership, with each 13 largest BSC Parties each take a share in Elexon
  - We continue to be independent and neutral

# Budget setting options

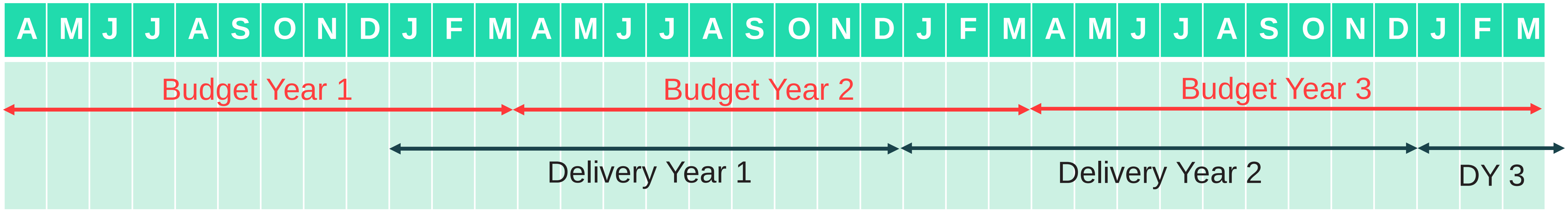
**Is the process linked to (or separate from) the existing BSC budget-setting process?**

- Option 1a – Include the MF budget in the BSC budget setting process, with no direct appeal mechanism, instead the Resolutions process could be used

- Option 1b - Include the MF budget in the BSC budget setting process, but carve out an appeal mechanism for the MF element
  - What is different about MF budget that requires a separate appeal process?

- Option 2- Include the MF budget in new standalone MF arrangements, outside of BSC governance

- Under all options the budget will be set across BSC financial years which run April to March
- Under the BSC, we set a three-year budget, which will allow us to forecast and set budgets to align with the Delivery Year period (which is subject to Ofgem policy and our Workshop on developing Delivery Plans)
- This diagram is just for illustration and will be revisited in the next Workshop





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## Budget setting options – preferred option 1b

- Ofgem propose that the MF budget should be subject to appeal. We therefore propose:
  - Including in the existing BSC budget setting process is efficient and removes the need to implement new budget processes whilst maintaining transparency
  - Uses processes familiar with BSC Parties
  - Avoids the need for Parties to respond to multiple budget consultations
  - We would carve out an appeal right for the MF element of the BSC budget

**Proposed High level appeal mechanism**

- Any BSC Party can appeal, but must have raised the concern with BSCCo or the BSCCo board during the development of the budget e.g. as part of the consultation
- Appeals must be submitted to the Authority (Ofgem) within [15] working days of the board's approval of the budget and notify BSCCo
- Ofgem may then:
  - Refer the cost item back to the BSC Board for further consideration and potential revision
  - Reject the appeal where it does not meet the grounds for appeal or that are vexatious or trivial

- Grounds for appeal:
  - Was not adequately consulted upon, or the BSCCo Board failed to reasonably consider consultation responses
  - Is not a legitimate expenditure for the BSCCo Board
  - Is a manifestly inappropriate provision for the activity in question, with insufficient safeguards to ensure cost efficiency
  - Unfairly prejudices the interests of one or more Parties or could cause them to breach the BSC, Energy Licences, and/or Law

- While an appeal is under consideration, BSCCo is not prohibited from incurring costs related to the disputed item, especially if necessary to fulfill legally binding obligations

Do you agree with our preferred budget setting option and why?

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# Do you agree with our preferred budget setting option and why?

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## Is there involvement from a Stakeholder Advisory Board (SAB)?

- Ofgem are proposing to include a SAB as part of the MF governance arrangements, and that the SAB should play a role in the setting of the MF budget, as outlined below

- The SAB shall be invited to review and comment on the MF budget following the publication of the BSCCo Business Plan and budget
- Comments must be received within the timescales of the BSCCo Business Plan and budget consultation period
- The SAB shall not set or approve the budget, but the BSCCo board shall consider the SAB’s comments in setting and approving the budget
- This is comparable to role of the BSC Panel for the BSCCo budget

Should BSC Panel be able to comment on the MF component and should the SAB be able to comment on non-MF components?

- We don’t believe any restrictions should be placed on this as all views should be welcome
- In practice it is likely that the SAB would focus its comments on the MF component and the Panel on the non-MF components

Do you agree with our proposals for the SAB and why?

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# Do you agree with our proposals for the SAB and why?

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# How is the budget approved (e.g. role of Elexon Board)?

- We have identified the BSCCo board or Ofgem as suitable candidates for approving the MF budget
- If the budget is set as part of the current BSC budget process, then the BSCCo board should also approve it
- Ofgem have stated that they want the MF to set its own budget i.e. not be submitted to Ofgem for approval

- We therefore propose that the MF budget is approved by the BSCCo board as part of the BSCCo Business Plan and budget setting process
  - This is in keeping with good corporate governance practices and existing BSC practices which will also reduce implementation and operational costs
  - Additional check and balances for MF budget are proposed alongside this:
    - SAB feedback and scrutiny
    - Appeal to Ofgem

Do you agree that the BSCCo board should approve the MF budget and why?

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# Do you agree that the BSCCo board should approve the MF budget and why?

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# FINANCE PROCESSES

# Finance Processes

- How often are funding parties invoiced?
  - MF amounts included on existing BSC invoice as new line item
  - Daily - not efficient or proportionate for Parties or Elexon
  - Monthly -  this is our preferred option, as it is a standard Elexon finance billing cycle and allows us to use existing systems and processes
  - Quarterly – could be done quarterly for any options that are more predictable and stable (NESO or DSO/NESO split), but this would rule out using existing BSC systems
- What happens if there is a shortfall because some of them don't pay?
  - We propose to use the existing Section D mutualisation process – this works under any option
  - Not justified to include new Credit Cover (CC) arrangements for MF.
    - This is consistent with other schemes e.g. currently CC only covers Trading Charges and not operational costs (as proportionate to sums of money involved)
- How are budgeted and actual costs reconciled?
  - Funding share options – reconcile within month
  - Fixed rate per MPAN or DSO/NESO split - annually
  - End of year – for all options
- What payment mechanisms are allowed for funding parties to pay MF invoices?
  - Same as for BSC Parties i.e. Direct Debit or electronic bank transfer
- How should any MF shortfalls be managed?
  - Use existing BSC in-year adjustment process
    - Consult on new budget, including SAB comments, then board approval

Do you agree with our finance proposals and why?

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# Do you agree with our finance proposals?

ⓘ Start presenting to display the poll results on this slide.

# Summary

| Consideration | Preferred option | Reason |
|---|---|---|
| What class(es) of party should fund market facilitator? | NESO | NESO will be the primary users and beneficiaries of the service and have driven the need for the MF. Most of the markets we'll be facilitating (measured by volume) are ancillary services funded through BSUoS. |
| How should costs be apportioned between them? | Annual amount split into 12 monthly amounts | This is simple and transparent and reduces costs to implement and operate |
| Is the process linked to (or separate from) the existing BSC budget-setting process? | MF budget will form part of the BSC budget setting process and hook into the Section D and H mechanisms | This uses well established and regarded processes that are familiar to BSC Parties (that includes NESO and DNOs).<br>Hooking int existing BSC non-payment and default processes reduces implementation and operational costs |
| How is the budget approved (e.g. role of Elexon Board)? | The BSCCo board will approve the MF budget, as it does for the BSC budget | This is in line with good corporate governance practices. Ofgem propose that MF set its own budget. |
| Checks and balances (to ensure stakeholder concerns are addressed | BSC Parties will be able to appeal the MF budget to Ofgem and the SAB will provide scrutiny | This is in keeping with Ofgem proposed policy |
| How often are funding parties invoiced? | Monthly | In line with Elexon billing cycles to reduce cost |
| What happens if there is a shortfall because some of them don't pay? | Will use existing Section D process, but highly unlikely as NESO funding | This is efficient as it removes the need to build new systems and processes |
| How are budgeted and actual costs reconciled? | Annually | Any unused funds will be returned at year end. Can use existing mechanism to amend budget if changes to Delivery Scheduled require material adjustment to budget within period |

## How are we meeting the Ofgem proposal set out in its Policy Framework consultation?

| Requirement | How are we proposing we will meet it? |
|---|---|
| Budgets are cost reflective | We operate on a not-for-profit basis |
| Costs included should be set out in a clear and transparent manner | Costs will be included in the BSC budget setting process, which is subject to consultation |
| Costs should not be demonstrably uneconomical, wasteful or inefficient | The business plan and delivery plan will evidence our required expenditure that will be subject to public consultation and appeal.<br>We practice strict financial disciplines and make decisions based on value for money |
| Elexon as market facilitator must publish a draft budget ahead of the relevant year for a set consultation period and invite comments from stakeholders. Consultation responses must then be considered and responded to, as part of finalising the budget | The BSC budget setting process, which we propose to use for setting the MF budget already incorporates these requirements |
| The final budget is subject to an appeals process, enabling stakeholders to dispute the final budget subject to an agreed process and specific criteria, as described in paragraphs 3.46 and 3.47 | We will work with Ofgem to finalise the process to ensure these requirements are met |

# Summary – alignment with Ofgem governance outcomes

- How have we met Ofgem’s governance outcomes for the MF in relation to budgeting and finance:
  - Accountable – Stakeholders and the SAB will be invited to comment on the budget and BSC Parties will be able to appeal the budget to Ofgem
  - Efficient – our proposals make use of existing processes and mechanism for efficiency, where appropriate
  - Delivery at pace – our proposals are deliverable within the timescales
  - Inclusive and collaborative – we will factor in feedback from this workshop and consultation, the proposals themselves include public consultations, checks and balances and scrutiny from a Stakeholder Advisory Board
  - Transparent – we will include our forecasted budget in our business plan for consultation
  - Trusted – we will do what we say we will do

# NEXT STEPS

# Next steps

- Our next meeting is on the **Market Coordination Delivery Plan** and is scheduled for [**23 Jan 25**]
  - We will share slides by 17 Jan 25
- We will share a high-level summary of this meeting and publish it on our website within the next week
- You can access the questions from today here: Market Facilitator Workshop 2 Questions

## Detail Design Timetable

| Workshop | Date |
|---|---|
| #1 Scope and deliverables | 27 November 2024 |
| #2 Budgeting and Finance | 18 December 2024 |
| #3 Market Coordination Delivery Plan | 23 January 2025 |
| #4 Enduring Change Management | 6 February 2025 |
| #5 Implementation Monitoring | 20 February 2025 |
| #6 Wash-Up of Remaining Governance Topics – revisit Budgeting and Finance | 4 March 2025 |
| #7 Mop-Up and Holistic Review | 20 March 2025 |
| MF Detailed Design Consultation | April 2025 |

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# THANK YOU

MF@elexon.co.uk

18 December 2024