ELEXON

Market Facilitator Workshop 2 – Budgeting and Finance Summary

Meeting number	**2**	Venue	**Virtual via MS Teams**
Date of meeting	**18 December 2024 – 10am to 2pm**	Classification	**Public**

Summary

1. Welcome & Introduction and Objectives

The Chair opened the meeting by welcoming attendees and providing an overview of the purpose and intended objectives of this Market Facilitator Workshop. The session aimed to achieve three key objectives:

- to agree on who should fund the Market Facilitator and how costs should be apportioned
- to agree on the Market Facilitator budget-setting process
- to agree on the financial processes, including billing cycles, reconciliation, and mutualisation.

The Chair highlighted the importance of reaching a consensus on these foundational elements to ensure the effective financial governance of the Market Facilitator role. The Chair highlighted the need to revisit these topics at later Workshops in response to feedback received during Workshop 1, to factor in the feedback from this workshop and to validate a number of assumptions that have been made at this stage. The Chair also introduced Elexon's new Head of Flexibility.

2. Cost Recovery Model

- **Who should fund the Market Facilitator (MF)? – Introduction:**

This section covered background and context for the cost recovery model. The discussion re-capped on Ofgem's requirements in this area (set during the Ofgem workshops and in its Policy Framework consultation), for example on how the Market Facilitator (MF) will set its own budget, driven by the Delivery Plan. The proposals from this workshop, as from all MF workshops, will be consulted on with stakeholders before submission to Ofgem for approval.

Currently, transitional MF costs are treated as Balancing and Settlement Code (BSC) Costs, funded by BSC Trading Parties. The focus for this workshop is on identifying an enduring cost recovery mechanism. Elexon highlighted that most of the flexibility falling within MF scope is purchased by NESO as anciillary services, the cost of which is recovered through Balancing Services Use of System (BSUoS) charges, and this is therefore a potential option for recovering MF costs. This reflects Elexon's preferred approach, based on cost causation principles.

Existing cost recovery models for other Elexon services, such as the Capacity Market Advisory Group (CMAG), Electricity Price Guarantee (EPG), Data Integration Platform (DIP), and Market Wide Half Hourly Settlement (MHHS), were reviewed to provide context. The enduring solution must be transparent, efficient, and proportionate to ensure fairness and operational effectiveness.

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

Elexon presented 5 assessment criteria that it proposes are used to evaluate who should fund the MF and how the costs should be apportioned. Cost causation ensures that those who use or benefit from the MF service bear the associated costs. Fairness requires the funding mechanism to distribute costs equitably without creating barriers to entry. Simplicity and transparency ensure the approach is straightforward to implement and easy for stakeholders to understand. Predictability and stability emphasise avoiding sudden changes that could disrupt market participants. Finally, administrative efficiency ensures the solution remains proportionate, minimising implementation and operational costs relative to the funds being recovered. Elexon invited feedback on these criteria.

Stakeholder feedback on this section:

- A participant asked for clarification on who will use the Market Facilitator (MF) service, noting it is clearer for Elexon's other services. Elexon responded that the primary users are expected to be NESO and Distribution System Operators (DSOs), but Suppliers could also benefit. They acknowledged differing perspectives on cost causation, with networks driving the need for the service while the facilitation of distributed assets and flexibility markets ultimately benefits Suppliers.
- A participant raised a question on how the premium for pace could be incorporated into the financing process, noting that accelerating work may require additional funding. Elexon acknowledged the point and suggested this could be addressed under budget setting, process topics, or the delivery plan workshop. Elexon further noted that if pace is identified as a priority, it should be factored into the delivery plan and tied closely to the budget-setting process to ensure timely delivery.

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

The funding options for the Market Facilitator have been narrowed to System Operators, Suppliers, and BSC Trading Parties, with Flexibility Service Providers (FSPs) ruled out to avoid barriers to entry in a sector that is developing and increasing liquidity is a key objective for MF. Elexon presented NESO-only as its preferred option, citing alignment with ancillary service markets funded through BSUoS charges. A combined DSOs and NESO option adds unnecessary complexity, while funding through Suppliers also has merits (as BSUoS and DSOoS are both ultimately collected from consumers via Suppliers), Elexon explained that Suppliers may struggle to recover these costs under the Price Cap. BSC Trading Parties were considered as a practical, low-cost alternative due to proportional cost recovery under the BSC.

Stakeholder feedback on this section:

- A participant highlighted that BSC Trading Parties should not fund the Market Facilitator, as it would be challenging to establish a clear link between them and the cost causation. Elexon clarified that BSC Parties were considered primarily for simplicity of implementation, not cost causation alignment.
  - A participant raised concerns about exempting Flexibility Service Providers (FSPs) from funding the Market Facilitator, arguing that it does not align with the cost causation principle since FSPs would benefit from the service without contributing. They also highlighted worries regarding network charges or charges being passed on to Suppliers. Another participant disagreed slightly, acknowledging the concern but emphasising that Suppliers would ultimately collect the costs while flex providers would still benefit. They suggested it would be simpler and clearer for System Operators, rather than Suppliers, to fund the Market Facilitator. They also noted the importance of ensuring impartiality, raising a concern that exclusive funding by NESO might create issues for DSOs about the neutrality of the MF.

- **Where should the funding arrangements be implemented?**

Elexon proposed implementing the Market Facilitator's funding arrangements within the BSC as all of the proposed funding parties are also BSC Parties and so can be legally bound (via the BSC) to fund the MF. Including these arrangements in the BSC also enables existing processes to be leveraged and consequently minimises costs (as it avoids needing to re-create new processes and systems). This approach aligns with Ofgem's policy to avoid inefficiency and unnecessary complexity. Alternatively, Elexon considered implementing the cost-recovery, budgeting, and finance rules in standalone MF documents. However, this would add unnecessary costs and complexity without clear benefits over the BSC option, except for reducing the risk of Code Reform impacting the MF arrangements in the BSC. Elexon stated that including the rules within the BSC is seen as more efficient, particularly for a NESO-only option, as it simplifies integration, and provides a smoother transition. For these reasons, Elexon proposed implementing the MF funding rules via a BSC Modification.

Stakeholder feedback on this section:

- A participant noted the importance of being mindful of the significant volume of change that could follow the implementation of new processes. Elexon agreed this was a reasonable assumption. The participant also queried whether a separate change process, similar to DIP Change and DCAB for MHHS, would be required. Elexon confirmed that a new MF change process will be designed, but that any rules included in the BSC could be subject to the existing BSC Modification Procedures (rather than carving out a new MF change process within the BSC).
- Stakeholders agree implementing into the BSC well help to keep it as efficient as possible to minimise costs for the end consumers.
- A participant suggested it would be sensible to leverage existing BSC rules and systems to ensure efficiency, provided there is an effective remedy for non-payment.

- **What is the impact on the DSO, NESO price control and on the Supplier price cap?**

The impact of the MF funding arrangements on different stakeholders was discussed in three key areas: DNO (including DSO) price control, NESO price control, and the Supplier price cap.

DNOs are regulated under Ofgem's Revenue = Incentives + Innovation + Outputs (RIIO) framework, specifically RIIO-Electricity Distribution 2 (ED2), which runs from 2023 to 2028. This framework sets outputs for DNOs and the associated revenues they can recover, providing a structure for their business plans. Ofgem is currently consulting on RIIO-ED3, which will define arrangements for the next regulatory period.

NESO operates on a not-for-profit basis under Ofgem regulation, funded through BSUoS charges as part of a '100% fast money' approach. NESO's Financial Model outlines how revenues are recovered via external and internal costs. NESO is assumed to pass MF costs to Suppliers under BSUoS tariffs, aligning with its existing processes. This approach leverages NESO's established financial mechanisms for recovering costs efficiently. However, it does need to be confirmed if any NESO licence changes or CUSC changes would be required to explicitly allow for MF costs to be included and recovered.

BSC costs, which include MF transitional costs, are passed through to Suppliers under the Price Cap operating cost allowance. Although indexed, the allowance does not currently account for the latest BSC budgets. While MF-related cost increases are expected to be minimal, Ofgem is reviewing options to incorporate industry charges more regularly. It is assumed that Suppliers could fully recover MF costs from consumers through BSUoS or Distribution Use of System (DSUoS) charges, but only partially if invoiced directly from Elexon. Any additional costs are expected to have a negligible material impact.

Stakeholder feedback on this section:

- It was queried whether any differences between DNOs and DSOs are expected as the term has been used interchangeably. Elexon confirmed this would not be the case.
- A participant queried whether there were estimates available for the costs of running the Market Facilitator, particularly in relation to materiality and potential price control implications. Elexon confirmed that their upcoming business plan, due to be issued next week, includes a forecasted cost of £1.6 million for 2025/26.
- A participant confirmed there would be an impact on DNO licences and price control changes.
- A participant queried whether the overall cost recovery for DSOs includes both core development activity and the time and effort spent in workshops or related development processes. Elexon clarified that the forecasted budget of £1.6 million reflects the costs to be recovered for MF costs, mostly related to Elexon resources, but does not include DSO contributions of time or expertise to workshops or working groups. The participant sought confirmation that any subject matter expertise offered beyond this budget would not be accounted for, to which Elexon confirmed this understanding as correct.

- **Apportionment options summary**

Elexon presented seven apportionment options for funding the Market Facilitator, with a proposal that all options involve monthly calculations and invoicing, aiming to narrow down to a preferred option or shortlist following further discussion.

- **How could funds be recovered? – Suppliers**

Elexon outlined three options for recovering funds from Suppliers. Option 1, funding share based on MPAN counts, offers faster reconciliation but requires more system development. Option 2, specified unit charge per MPAN, provides cost certainty with minimal system changes but slower reconciliation for underspend. Option 3, funding share based on energy volumes (MWh), aligns with energy use but introduces volatility and forecasting challenges due to volume fluctuations.

Stakeholder feedback on this section:

- The impact of any Central Volume Allocation (CVA) sites with Final Demand was raised and what would be the materiality on any Supplier apportioned methodology based on volumes of MPANs that would exclude any CVA Final Demand. As the Market Facilitator focus was on flexibility services outside of the Balancing Mechanism the use of MPANs as an apportionment method would still be a credible approach to cost recovery.

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

Elexon presented two options for recovering funds from NESO and DSOs. In both options it is proposed that NESO have a fixed apportionment applied to them that will be determined under the budget setting process, an example of 50% of the total MF costs was used to illustrate the concept. Option 4 proposes a fixed apportionment of costs based on licensed DNO areas, offering cost certainty, simplicity, and low implementation costs, but it does not account for variations in size or connections. Option 5 uses MPAN counts to apportion costs across DNOs, which is more reflective of customer size but introduces additional complexity and higher implementation costs due to ongoing data updates and dependencies. Both options would require processes for cost recovery and reconciliation and could potentially pass costs to Suppliers and, ultimately, consumers.

Stakeholder feedback on this section:

- Out of these two options Elexon indicated a preference for Option 4 due to its simplicity, which stakeholders supported. While Option 5 was acknowledged as a fairer approach, it was deemed too complex to justify the associated costs and benefits, given the amount of money to be recovered.

- **How could funds be recovered? – NESO only**

Elexon explained that Option 6 proposes recovering MF costs through a fixed cost paid entirely by NESO. This reflects Elexon's preference due to NESO's role in ancillary services funded via BSUoS charges. NESO's dominant role, larger scale, and critical importance to flexibility markets make this a logical approach. The option is described as transparent, predictable, and simple, requiring annual reconciliation and a process for cost recovery and non-payment. Ultimately, the costs would be borne by consumers.

Stakeholder feedback on this section:

- Stakeholders agreed that this option is the simplest solution, with its efficiency and transparency also being highlighted.
- One participant who supported Option 6, highlighting its simplicity, transparency, and alignment with the majority of markets funded through BSUoS charges. They noted NESO's dominant role in ancillary services as a strong rationale for this approach.
- Another participant expressed concerns about the impact on consumers, suggesting that funding through NESO might lead to increased costs being passed on.

- **How could funds be recovered? – BSC Trading Parties**

Option 7 suggests recovering Market Facilitator costs by spreading them across BSC Trading Parties using the existing Section D process. This approach requires no system development, includes both Suppliers and Generators, and aligns with how MF costs are currently recovered during the implementation period. Existing BSCCo processes for cost recovery, non-payment, and escalation would apply. Elexon highlighted that it thought it appropriate to rule this option out as it would recover ~50% of the costs from large transmission connected generators who would not benefit from the MF service.

- **Assessment of Options against Assessment Criteria**

NESO and DSOs were identified as the primary users and beneficiaries, aligning with cost causation. Fairness was addressed by recognising that market share options could avoid burdening smaller participants but might lack reliable data and be costly to implement. Simplicity and transparency favoured straightforward solutions like NESO funding or regional DSO splits. Predictability and stability highlighted the volatility of energy volumes, with NESO being the most stable option. Finally, administrative efficiency showed that recovering costs through BSC Trading Parties or NESO would be the most cost-effective solutions, while DSO splits based on MPANs were deemed the least efficient due to implementation challenges.

The DSOs and NESO option was dismissed as it adds complexity without consumer benefits compared to NESO-only. Suppliers were excluded due to inefficiency and potential impacts on the Price Cap. Lastly, BSC Trading Parties were ruled out as it would unfairly place costs on large generators who do not use flexibility services.

- **What is the preferred option?**

Elexon stated their justification for Option 6 – Fixed cost on NESO Elexon stated its preference for Option 6 (fixed cost on NESO), citing NESO's dominant role in ancillary services, its alignment with BSUoS charges, and administrative simplicity. This preference reflects Elexon's assessment of cost causation principles and efficiency.

Stakeholder feedback on this section:

- A participant commented that the DSO-only option does not make sense, as it lacks the administrative simplicity of the NESO-only option, which provides a clear benefit. They also highlighted potential inequities between the two kinds of System Operators, noting that the DSO-only option is more complex than it appears.
- A participant noted that the assumptions around DSO markets not increasing significantly over time may need to be reconsidered, as these markets, while currently small, are expected to increase as DSO flexibility products evolve. Elexon responded, agreeing that rules and processes should be kept under review, highlighting that NESO offers a low-cost implementation and operation option, with flexibility to change later if justified through the enduring change process (to be developed in workshop 5).

- **Preferred Option against Assessment Criteria**

The assessment of NESO as the preferred option was presented against key criteria: NESO was identified as the primary user and driver of the Market Facilitator (MF) role, aligning with the cost causation principle. Elexon believes this approach is deemed fair as it avoids overburdening smaller participants, with costs recovered via BSUoS, which is based on final demand volumes. NESO offers simplicity and transparency, as the annual amount can be recovered from a single entity. The option is also predictable and stable, with fixed monthly costs, and administratively efficient as it avoids system changes and can be managed within existing finance processes.

Stakeholder feedback on this section:

- One participant broadly agreed but highlighted concerns that DSO markets, though currently small, could grow and transform over time, suggesting the need for ongoing review. Another participant noted that while the DSO-only option seemed administratively simple, it still presented potential inequity between different types of System Operators.
- One participant expressed they were happy with NESO funding MF as well as a preference for Option 4.
- It was also suggested that NESO could be invoiced annually rather than monthly, for simplicity, given the sums of money involved.

3. Budget Setting Process

- **Ofgem Market Facilitator Policy Framework**

Elexon summarised the Ofgem requirements set out in its Policy Framework consultation. The MF will set its own budget ahead of each year, subject to a draft consultation period, stakeholder scrutiny, and an appeals process. Budgets will be cost-reflective, clearly presented, and avoid inefficiency or waste. The draft budget will undergo consultation, with feedback considered before finalisation.

Stakeholder Advisory Board (SAB) input is proposed to provide external oversight, ensuring the budget aligns with stakeholder expectations. Final approval involves checks and balances, including consultation, SAB engagement, and an appeals process to address any disputes.

The appeals process will include clear criteria to validate appeal grounds, limit misuse, and ensure the process does not delay ongoing activities. Appeals must relate to specific budget items, and Ofgem will not be required to set new budget values. Additionally, the budget aligns with a two-year Delivery Plan and a more granular one-year Delivery Schedule to ensure detailed planning and execution.

- **BSC Business Plan and Budget Setting Process**

Elexon outlined the BSC Business Plan and Budget Setting Process, where the BSC requires Elexon to produce a business strategy and an annual budget for the Plan Year and the two subsequent financial years. Budgets focus on delivering BSC and EMR obligations, with the BSCCo Board ultimately responsible for approval, following consultation with the BSC Panel and industry.

Elexon further clarified that BSC budgets cannot be appealed, as Ofgem rejected a recent proposal (P416) for an appeals mechanism. However, BSC Parties can challenge budgets through Voting Party Resolutions. This includes voting to remove directors or raising resolutions, which can be binding or non-binding, provided they meet the required 5% voting share threshold.

- **BSC Board Constitution**

The BSC Board Constitution sets out the governance structure and operational oversight of Elexon. The Board comprises members with multi-disciplinary experience and adheres to corporate governance best practices, remaining accountable to BSC Parties. Authority for day-to-day operations is delegated to the Chief Executive.

The Board's composition is determined by the Nomination Committee, requiring a majority of directors to have electricity experience, at least two independent directors, and no more than two directors from BSCCo (including the CEO). The Panel Chair can also serve as the BSCCo Chair, which is currently the case.

- **Budget setting options**

Three budget-setting options were presented: Option 1a integrates the MF budget into the existing BSC budget-setting process with no direct appeal mechanism, relying instead on the Resolutions process; Option 1b also uses the BSC process but introduces a separate appeal mechanism for the MF element; and Option 2 creates a standalone MF budget process outside of BSC governance.

The preferred option is Option 1b, as it retains alignment with the BSC budget-setting process while meeting the Ofgem requirement for a dedicated appeal mechanism (for the MF budget). This approach balances efficiency and accountability.

Stakeholder feedback on this section:

- One participant queried whether the budget and delivery years needed to differ. Elexon confirmed this was not a requirement but noted that aligning with the BSC budget-setting process would necessitate financial years running April to March. Ofgem suggested delivery years align with calendar years, but this is not final, and they are open to revisiting the approach for better alignment.

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

Ofgem proposes involving a Stakeholder Advisory Board (SAB) in the Market Facilitator (MF) governance arrangements, with the SAB invited to review and comment on the MF budget following the publication of the BSCCo Business Plan and budget. While the SAB will not set or approve the budget, its comments will be considered by the BSCCo Board during budget approval. This role mirrors the BSC Panel's involvement in the BSCCo budget. All views are welcome, with the SAB expected to focus on the MF component and the BSC Panel likely commenting on non-MF elements.

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

The BSCCo Board is proposed to approve the Market Facilitator (MF) budget as part of the BSCCo Business Plan and budget-setting process. Ofgem has indicated that the MF should set its own budget without requiring Ofgem's approval. This approach aligns with corporate governance and BSC practices, reducing costs and implementation complexity. Additional checks include Stakeholder Advisory Board (SAB) feedback and the ability to appeal to Ofgem.

4. Finance Processes

- **Finance Processes**

Finance processes will use existing BSC systems, with monthly invoicing preferred for efficiency. Shortfalls will be managed through the BSC Section D mutualisation process. Costs are reconciled monthly or annually, and payments will follow standard BSC methods. Any adjustments will involve SAB consultation and board approval.

- **Summary**

The preferred funding option for the MF is NESO, with costs apportioned annually into 12 monthly payments for simplicity and transparency. The MF budget will integrate into the existing BSC budget process, leveraging established mechanisms to reduce costs. The BSCCo Board will approve the MF budget, with checks and balances including stakeholder appeals to Ofgem, consultation and SAB scrutiny. Monthly invoicing aligns with Elexon billing cycles, while shortfalls will be addressed via Section D processes. Annual reconciliation ensures unused funds are returned, with flexibility to adjust budgets if delivery schedules change. The existing Section D mechanism can also be used to request additional MF funds, by doing an in-year budget (which effectively follows the budget setting process).

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

Elexon plans to meet Ofgem's policy framework requirements by operating on a not-for-profit basis and incorporating costs into the BSC budget-setting process, which is subject to consultation. The business and delivery plans will justify expenditures through public consultation and appeal processes, adhering to financial disciplines for value for money. Elexon will use the existing BSC budget process for stakeholder consultation and will work with Ofgem to ensure final budget approval aligns with agreed processes, including an appeals mechanism.

5. Next Steps

As a follow-up action, we will continue to engage with Ofgem to assess the impacts of price control and reflect on the feedback received. Additionally we will investigate what licence changes, if any, are allowed for NESO and/or DSO to fund MF. This process will culminate in a wash-up workshop, where we will present our latest thinking, addressing and incorporating feedback from both the first and second workshops. This approach aims to ensure that all viewpoints are considered and any concerns raised are appropriately addressed.

We will work collaboratively with Ofgem to define the scope, terms of reference, and governance structure of the Stakeholder Advisory Board (SAB) to ensure its role is clearly articulated and aligned with the needs of the Market Facilitator.

Actions

No.	Workshop raised	Action	Owner	Due by	Status
1.	WS2	Conduct Impact Analysis on NESO Price Control with Ofgem and NESO to analyse and understand the potential impact of the proposed funding arrangements.	Elexon	WS6	Open
2.	WS2	Engage in further discussions with Ofgem to refine and agree on the Terms of Reference, constitution, and governance framework for the Stakeholder Advisory Board (SAB).	Elexon	WS6	Open