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## **RE: Policy direction for the Future System Operator's regulatory framework**

### **Context**

Sembcorp Energy UK (SEUK), a wholly-owned subsidiary of Sembcorp Industries, is a leading provider of sustainable solutions supporting the UK's transition to Net Zero. With an energy generation and battery storage portfolio of over 1.3GW in operation or under development, our expertise helps major energy users and suppliers improve their efficiency, profitability, and sustainability, while supporting the growth of renewables and strengthening the UK's electricity system.

Our Wilton International site, within the Teesside Freeport, sits amongst a hub of decarbonisation innovation. At the site, we provide energy-intensive industrial businesses with combined heat and power (CHP) via our private wire network that supplies electricity generated by gas and biomass.

These services are complemented by our fleet of fast-acting, decentralised power stations and battery energy storage sites situated throughout England and Wales. Monitored and controlled from our central operations facility in Solihull, these flexible assets deliver electricity to the national grid, helping to balance the UK energy system and ensure reliable power for homes and businesses.

### **Q1) Do you have any views on our proposed financial regulatory framework for the FSO?**

In general, the regulatory framework for the FSO seems appropriate. With any new body, there may need to be adaptations as the body develops and grows, so the proposals in the consultation should not be considered suitable in perpetuity.

There are a few areas where it is not clear how regulation will work in practice, stemming mostly from the FSO's status as a government-owned institution, taking direction from the Secretary of State, and being regulated by Ofgem, who also are ultimately overseen by government. For instance, spend by the FSO may fall under the rules around managing public money, but is also subject to approval by Ofgem. As Ofgem and the FSO should both be led

by the Strategy and Policy Statement (SPS) published by the Secretary of State, it can be reasonably assumed that differences of opinion should be small and infrequent.

We agree that financial incentives are no longer appropriate: these would be, as stated in the document, payments from consumers to consumers, but will also help demonstrate independency. If such financial incentives were to have a distributional effect between users, that could create unbalanced incentives to lobby the FSO. There are concerns that the lack of financial incentive may reduce drivers for innovation and the cost-neutral nature of the FSO may reduce the drive or the most market-effective behaviour (which is not always the quickest or cheapest). Sufficient transparency of decision-making by the FSO and scrutiny by Ofgem should mitigate any negative impacts.

Using actual, rather than notional, company costs may not necessarily be less complicated or burdensome to report and carries a risk of data being misrepresented if taken out of context or poorly categorised. This can be mitigated by transparency and clear communication from the FSO and utilisation of actual costs should give more reassurance to industry through increased accuracy.

Sembcorp is concerned about the proposal for 100% 'fast money' within a year. Whilst it is coherent with the not-for-profit set up it creates a number of potential negative outcomes:

- Costs to consumers may become volatile if FSO's spending is not consistent over multiple years. There has been considerable effort put in by industry to stabilise Balancing Services Use of System (BSUoS) charges which would be reversed by the proposal as described.
- It will place temporal pressures on spend by the FSO – large projects may be delayed as the year's budget is already assigned, multiple large projects may push consumer costs above acceptable levels and so be rejected, or smaller projects may be brought forward to fill in a 'gap' towards the end of the year. Ideally, the FSO should progress projects based on identified need and consumer benefit, not to an annual budget.
- There is also a risk that, combined with the lack of financial incentives, it will discourage strategic long-term thinking over multiple years.

The 'fast money' period could be extended beyond a year, allowing the FSO to 'smooth out' spend and so provide stability to customer charges, or have a clear allowance for over- and under-recovery.

**Q2) Do you have any views on our emerging thinking on how we should regulate the FSO, including our objectives, the case for change, and potential future options?**

The objectives for FSO regulation are reasonable and trade-offs between them should be balanced by taking the SPS, industry view and external expertise (such as international

examples) into account. Transparency by the FSO's board to industry as well as Ofgem should demonstrate how those objectives are being considered.

Where the FSO's role is key in nascent markets even small details can have significant effects, such as where there are only a handful of participants. In these circumstances, a high-level regulation approach by Ofgem may not be sufficient to ensure a satisfactory outcome in the timescales required by Net Zero. The high-level approach described in Option 4 encourages restorative action after strategic goals have been missed, rather than on-the-go monitoring and increases the risk that strategic goals may be met primarily with the FSO's "preferred" solution, rather than innovation from within industry. We have no fundamental concerns around ex-poste FSO reporting, provided a high level of transparency on FSO actions, such as is the case currently, is continued.

**Q3) What role should industry stakeholders and external parties have in holding the FSO to account, and what platforms are needed to achieve this?**

The board should be comprised of individuals with the appropriate specific skill set for the industry. Given the FSO's obligation to secure best outcomes for consumers and the complexity of the industry, the board must have access to suitable experience within the energy industry, political neutrality and a long-term strategic understanding of the challenges Net Zero brings to Britain.

**Q4) Do you have any views on our approach to implementing changes?**

The most important aspect of implementation is continuity between current arrangements and the FSO, as experienced by industry. The Day 1 arrangements so far should provide that.

Yours sincerely,

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