



FSO Regulatory Frameworks

SSE Group Response to Ofgem's consultation, January 2024

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Executive Summary

About SSE

The SSE Group is a FTSE-30 company headquartered in Perth, Scotland with interests across the UK, Ireland, Europe, North America, and Asia Pacific. We provide energy products and services for businesses as well as developing and operating low carbon infrastructure including onshore and offshore wind, hydro power, electricity transmission and distribution grids, and efficient gas-fired generation where we are at the leading edge of decarbonisation with developments in carbon capture & storage and hydrogen. In November 2021, SSE announced a fully funded, £12.5bn Net Zero Acceleration Programme, creating 1,000 jobs a year out to 2025. In October 2023, this plan was upgraded to a fully funded £20.5bn five-year investment plan out to 2027. This response represents the views of SSE as a group, with input from our networks and energy businesses colleagues.

SSE Group Position

SSE welcomes the opportunity to respond to the FSO financial and performance regulatory frameworks consultation. We recognise that the transition from a private organisation to a public body means that a proportion of the existing performance management mechanisms will no longer be appropriate. We understand Ofgem's perspective that a not-for-profit body may have greater ability to focus on long-term strategic outcomes than a private organisation but given that the FSO's role in the GB gas and electricity industries is unprecedented and is a significant extension of the existing ESO's remit, it is critical that effective performance management is implemented.

Though we appreciate that Ofgem has noted the potential to influence senior manager incentives (or fitness to undertake senior roles), we consider such mechanisms as 'last resort' measures that will only be implemented in exceptional circumstances when long-term FSO poor performance is clearly apparent. Therefore, we recommend that Ofgem instigate a responsive performance management framework that allows stakeholders the opportunity to provide feedback on a regular basis (ideally annually) and has sufficient flexibility to increase or decrease the level of regulatory intervention as is required.

Going forward, we are keen to begin collaborating with the new FSO to address the challenges facing the sector, and we would welcome the publication of the consolidated FSO implementation timelines that Ofgem and the FSO are working to for the delivery of the Day 1 and enduring roles and responsibilities. There is a significant volume of work to be undertaken by Ofgem, TOs, the FSO and other industry stakeholders to prepare for the FSO inception and the publication of a clear, consolidated forward work programme would improve industry awareness and understanding of the transition.

Response to Consultation Questions

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

The consultation provides a high-level view of the proposed FSO financial regulatory framework and therefore the feedback we can provide is on a similar basis. To provide fuller feedback, we are keen to understand how this will work on more granular basis (e.g., a day-to-day and/or a week-by-week basis) to deliver the purported benefits for consumers.

We recognise that the FSO will be ‘funded by consumers through a 100% fast money approach’ but it is not clear how its funding basis will evolve. We would like to understand whether TNUoS charges will remain the sole source of FSO funding beyond emergency circumstances or whether Ofgem envisions other sources being made available to the FSO and, if so, what methodology will be applied to apportion funding costs between markets or sectors. In this context, it is important to recognise the financial interactions between the FSO and other parties, such as the TOs. Whilst it is noted that the government would ensure the FSO is able to manage any temporary cash flow issues, further clarity and comfort is needed on the FSO’s liquidity to ensure that TOs are not exposed to the risk of under-recovery of their own revenue. Additionally, as the FSO will be a not-for-profit organisation we would welcome further detail on how any underspend or financial surplus will be returned to the industry via reductions in future charges. To increase understanding within the industry, we would suggest that Ofgem and/or the FSO publish a summary document prior to FSO Day 1 to highlight how the FSO funding mechanisms will work in practice.

We agree that there is little value in assigning organisational-level financial incentives and penalties to the FSO, given that organisational costs are to be directly recovered from consumers. However, the proposed financial regulatory framework is largely based on the assumption that the removal of profit motive will ensure that the FSO is an effective organisation that will reach targets and benefit end users: ‘...we consider that a not-for-profit regulatory framework is more likely to achieve Ofgem and government’s shared objectives for the FSO and maximise benefits for Consumers’. Though we hope this to be the case, the removal of financial incentives means that it is critical that other measures are introduced to ensure that stakeholders (industry, consumers, suppliers, other network companies) can have confidence in the FSO as a proactive and efficient organisation. Accordingly, we would be keen to see more detail on the Ofgem assessment methodology of FSO Vfm and staff remuneration strategies.

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?

We agree that the objectives appear sensible and note that transparency is particularly crucial because this will drive the high performance and accountability of the FSO as a new organisation. Whilst there are existing regulatory mechanisms in place to promote ESO transparency, we would recommend that Ofgem consider whether that level of transparency is sufficient, particularly in view of the FSO’s wider remit and unique role as a public body. For example, we would propose that a greater level of detail on modelling assumptions, rationale and decision making employed by the FSO be made available to stakeholders. The CSNP would be a means for the FSO to exercise a greater level of transparency to stakeholders.

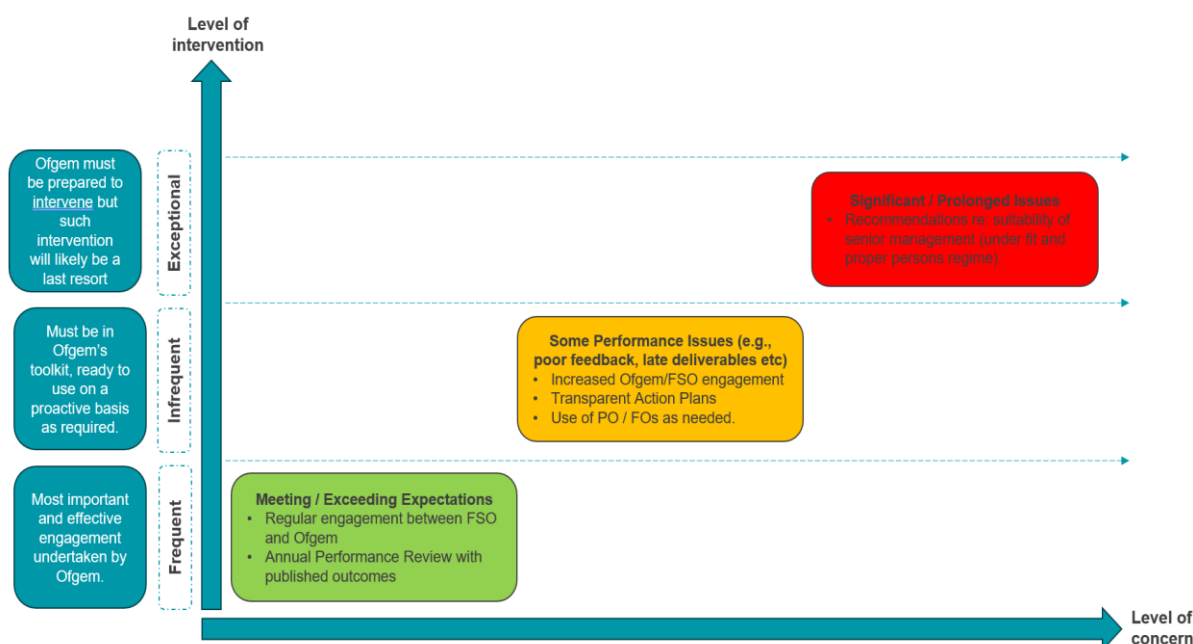
Comparison of the initial data versus the decisions made because of that information could form the basis of FSO post-implementation reviews. Those reviews would formulate key learnings for the FSO which could be made publicly available and, if appropriate, translated by either organisation into improvement plans with deliverable outputs.

As discussed above, accountability is a particularly important objective for the FSO to meet because its costs are to be directly recovered from consumers. We agree that energy consumers should be at the forefront of the FSO's remit but it is essential that the FSO adopts an industry strategy which will enable and promote all types of future investment in the GB networks, rather than simply focusing on the transfer of funds and other benefits from network connectees to end users.

Given the varied and new roles that the FSO will take responsibility for, it is important that the regulatory framework it is subject to has provision for significant flexibility from Day 1. The potential regulatory requirements to monitor FSO performance as distribution market facilitator delivery body (if successful) will be significantly different and will develop over time when compared to the existing ESO responsibilities. Likewise, the FSO involvement in nascent technologies like hydrogen production and CCUS will mature differently and therefore the regulatory framework implemented at Day 1 must be able to change to accommodate that. Broadly, we would welcome more detail from Ofgem on the potential impacts of the transition from ESO framework to FSO framework, particularly any anticipated changes in approach to network regulation.

We understand the rationale for a lighter-touch regulatory approach and a move towards testing the FSO against the delivery of longer-term objectives. As discussed in our response to Q1, if the FSO will not be subject to 'hard' enforcement measures (e.g., financial deterrents), it is essential that Ofgem has the means to trigger improvements where FSO poor performance is detectable and/or already proven. Besides financial deterrents, there are other means by which Ofgem could compel the FSO to provide proof of performance. For example, the use of Provisional and Final Orders by Ofgem would require the FSO to publish action plans or undertake certain actions when deemed appropriate. We agree that staff-level incentives make sense: it is important that the FSO recruit the right candidates into senior roles, and we would support the use of a methodology like Fit and Proper checks to ensure any senior management have the right skills and background to steer such an integral organisation. We would recommend a review of the existing Fit and Proper Persons regime prior to adopting this elsewhere in the industry to eliminate some of the current inefficiencies (i.e., identifying when Ofgem needs to be notified before/after any change in persons etc) and we would be happy to discuss this further if helpful. Whilst recognising the logic of Ofgem's proposals to influence senior manager incentives and/or fitness to undertake senior manager roles, it is critical to note that these interventions are likely to be exceptional in nature and, as a result, only employed where all else has failed. Ofgem must focus most of its attention on the mechanisms used to manage the more granular, day-to-day FSO performance, to mitigate the need to employ more substantial interventions. This further underlines the requirement for an effective performance framework to ensure there are appropriate performance management steps in place prior to any requirement to reach for more substantial interventions. Naturally, it is our view that the FSO's performance should meet or exceed expectations from its inception. In a scenario where this

isn't the case, we would advocate that Ofgem considers applying a sliding scale of engagement and escalation to mitigate and address the potential impacts of FSO poor performance:



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

It is crucial that annualised feedback from stakeholders (generators; network companies; service providers; suppliers) is reviewed and utilised by Ofgem as a benchmark when evaluating the FSO performance of the previous year. This could be undertaken via a standard consultation process and could include a response from Ofgem and the FSO to highlight how stakeholder feedback will help to shape future FSO performance and Ofgem evaluation.

In this vein, stakeholder feedback could be used by Ofgem to inform key performance objectives set to measure FSO performance on an annual basis. For example, the delivery of key reports (CSNP, Ten Year Statement, SSEP) could be fixed to publicised deadlines and therefore would be a measurable FSO output. Stakeholders could feed into the publishing sequence of these reports to maximise the benefits of such reports to the industry.

Engagement practices which already promote transparency (for example, the ESO performance panel) should be continued and used as a foundation for strengthened industry governance of the FSO performance. Considering the highly technical work associated with the FSO's expanded remit, a performance panel would provide an opportunity for detailed feedback and explanation to be regularly exchanged between the FSO and representatives of its diverse stakeholder base. If cooperation with this panel required the FSO to identify performance gaps and introduce solutions, this would ensure that there are clear milestones and deliverables set

for the FSO. Wider communications could also be published to provoke wider feedback from market participants as required.

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

In line with our comments above, we would recommend that Ofgem places less emphasis on the expectation that removing the ESO's profit incentive will implicitly ensure the FSO's positive performance. A sensible implementation approach would be to subject the FSO to a higher level of regulatory scrutiny from Day 1 and throughout the initial development stages, until Ofgem and wider stakeholders are confident that the organisation is functioning as expected and working successfully toward long term strategic goals.

Beyond this, we are keen to understand the specifics of stakeholder engagement opportunities at each implementation stage. More detail on how Ofgem plan to support the FSO in delivering new FSO objectives alongside the existing ESO RIIO-ED2 and BP2 obligations would also be welcomed.