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**Contact/Extension**

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Dear FSO Team,

**Policy Direction for the Future System Operator's Regulatory Framework Consultation**

This response is from SP Energy Networks (SPEN), representing licensees: SP Transmission, SP Distribution and SP Manweb. We welcome the opportunity to respond to the Future System Operator's Regulatory Framework Consultation.

SP Transmission is the Transmission Owner (TO) for Central and South Scotland, and we work closely on a day-to-day basis with the Electricity System Operator (ESO). This includes coordination on facilitating transmission connections, the Holistic Network Design (HND) and HND Follow-Up Exercise. The latter has represented a step-change in network planning and investment, made possible through the collaboration of TOs and the ESO. We are supportive of the FSO (*soon to be named the "National Energy System Operator"*) building capabilities to strategically coordinate the enduring Central Strategic Network Plan (CSNP). A deliverable CSNP, which aims to eventually cover other energy vectors, is dependent on collaboration with stakeholders utilising the expertise of existing parties, including TOs.

A summary of our response can be viewed below. Our detailed comments on the proposed regulatory framework for the FSO are set out in Appendix 1 of this response.

### **Summary:**

We are supportive of Ofgem introducing a regulatory framework for the NESO which is aimed at ensuring consumer interests are protected. However, we do not believe that the regulatory framework suggested in the consultation provides all of the necessary protections for consumers. We believe that a financial framework that provides ‘fast money’ is indeed the appropriate model for the NESO, although there is a need to safeguard consumers against increasing costs. We therefore propose that Ofgem introduces a threshold from which increased NESO costs will trigger an additional review by Ofgem.

### ***Financial Regulatory Framework***

The NESO’s focus should be on delivering consumer benefit and therefore should have a similar obligation to other regulated businesses to ensure that costs are incurred efficiently.

### ***The Role of Stakeholders***

We encourage Ofgem to consider the potential impact on consumer value where network companies’ existing roles and responsibilities are transferred over to the NESO. It is our view that there should be an impact assessment to assess risks to consumer value where roles and responsibilities are transferred.

It will be critical to ensure that the NESO’s security and resilience role is undertaken in collaboration with the existing network licensees, taking account of our detailed experience, expertise and knowledge history of the performance and condition of assets. Network security and resilience must remain to be a key focus for the NESO.

We believe that stakeholders should have an ability to influence the performance metrics of the NESO and hold them to account where they believe there is a need to do so. We propose that an annual NESO report is published by Ofgem setting out the NESO’s key deliverables. This will allow stakeholders to respond via a formal consultation to Ofgem with their views.

### ***Implementing Change***

We are supportive of Ofgem’s approach to implementation, although have some concerns over potential conflicts of interest. We are keen for Ofgem to set out how it intends to manage potential conflicts of interest arising from a single entity setting the strategic direction of the codes that govern the industry; set the market conditions; plan; and operate the network. We believe that Ofgem should consider how to ensure that the TOs and wider stakeholder expertise and skills, as well as any concerns and feedback, are factored into the decision making of the NESO when setting the strategic direction of codes, setting market conditions, and planning the network. We would therefore advocate that there is an effective and efficient escalation, appeal, and governance processes, led by Ofgem, in place if these are required.

### ***RESP***

On 15 November 2023 Ofgem published their decision on [the future of local energy institutions and governance](#). This included a decision to introduce Regional Energy Strategic Planners (RESPs) to ensure there is appropriate accountability and effective coordination for strategic planning at a sub-national level. The NESO has been designated as the delivery body for this role.

The detailed design of RESP by Ofgem and the ESO is ongoing and there is still a lack of clarity on the specifics of the RESP roles and functions. One of the main workstreams of this detailed design phase is development of RESP governance mechanisms.

We ask for clarification from Ofgem on the regulatory framework proposals within this consultation and how they may relate to the RESP function. As the development of RESP is still at an early stage, an understanding of the relationship with the NESO is essential.

If the proposals in this consultation do have a relationship with RESP, then it is important that we highlight to Ofgem that currently it is difficult to appropriately consider the implications of these proposals at such an early stage of RESP development. Full consideration of these proposals, and their implications on RESP, should only take place at such time as RESP detailed design has progressed to a stage where roles and responsibilities have been fully clarified.

Yours sincerely,

David Boyland  
**Acting Head of Transmission Regulation and Policy**

## Annex 1 – Responses to Consultation Questions

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

We are supportive of Ofgem introducing a regulatory framework to ensure licence compliance of the FSO. It is important that Ofgem uses this opportunity to continue to safeguard consumer interests. This includes ensuring that the network is resilient and there is security of supply. The logic behind the proposed regulatory framework makes sense as the not-for-profit model is a sufficient way to avoid a circular compensatory organisation for consumers.

The FSO will need to have a similar obligation to other regulated businesses and should have an obligation to ensure that costs are incurred efficiently, thereby maximising the consumer benefit of having a publicly funded FSO.

In terms of the fast money approach, we are supportive of this provided there are sufficient safeguards in place to ensure that costs are sufficient prior to them being incurred. We are supportive of Ofgem's proposal to have some form of ex-ante cost assessment prior to the FSO incurring expenses. Where the FSO's expenses exceed a threshold of, for example, 20%, we believe that this should trigger an additional review by Ofgem.

### 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 are supportive of the seven objectives Ofgem suggested in the consultation, although we have some concerns over two of them. In terms of the independence objective for the FSO, we are concerned over how Ofgem intends to ensure the FSO remains operationally independent to government. The FSO is intended to create and implement strategic plans that TOs and DNOs are obligated to deliver, although there is a lack of clarity on how independent this will be from the influence of government.

This factors into our concerns over accountability. Using this consultation as the basis, we are not confident that Ofgem can truly hold the FSO to account if there are failures on the FSO to deliver on its licence conditions. As stated, it would not be likely that the FSO will be subject to licence revocation or any penalty as this would go against the interest of consumers. We understand from the consultation that Ofgem intends to incentivise the senior management of the FSO through risks to professional reputations and evaluation of compensation awards. We are not convinced that this metric will provide sufficient safeguards that the FSO will deliver on the critical infrastructure needs to maintain security of supply and a resilient network. We believe that there should be a collaborative approach between TOs, ESO / FSO, DESNZ, the Devolved Administrations and Ofgem which is necessary for network and spatial planning via the SSEP. The FSO alone would not have the requisite knowledge or experience to make these complex decisions. The result would be an FSO that will have the trust and support of the energy industry, while alleviating concerns over accountability as network operators will be involved in the process throughout.

We are concerned that an appropriate assessment of the FSO or Elexon against the design principles stated in the Market Facilitator consultation is impossible without any accompanying cost benefit analysis of the relative costs/benefits of these organisations acting as market facilitator rather than purely an assessment against the design principles.

We believe that, given the FSO's designated role with the Energy Act, and Ofgem's previously stated preference that the FSO should act as market facilitator, many of the relative benefits of appointing Elexon may have been disregarded. We maintain that the FSO cannot satisfy any requirement of impartiality. We consider Ofgem to have the necessary powers to ensure impartiality of the market facilitator by use of Investigation and Enforcement powers, which will hold an entity to account.

Considering the four options in the consultation on how to implement the performance incentive. We are supportive of a blended version of both option one and option four. This will involve Ofgem evaluating the FSO's performance and detailed delivery outputs while placing an obligation on Ofgem to rely on ex-ante FSO reporting requirements during its evaluation. We encourage Ofgem to consider such reporting to also include an obligation to evidence what the FSO has done to mitigate / address concerns raised by stakeholders, and where the FSO has not addressed concerns, there should be an obligation to provide sufficient justification for the decision. Ofgem should factor this into their evaluation of the FSOs overall 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?

We would urge the Government and Ofgem to consider the existing roles, responsibilities, and expertise of network companies when developing the FSO and how best the FSO and network companies can collaborate to deliver the best outcomes for GB consumers, building on the recommended approach used for the HND. As such, we consider it is essential that an impact assessment of transferring network companies' existing roles and responsibilities to the FSO is undertaken, including a consumer value impact assessment. Expanding the FSO role too widely and too quickly without a robust impact assessment also risks the timely delivery of infrastructure at a critical time for the electricity system in delivering net zero.

It will be critical to ensure that the FSO security and resilience role is undertaken in collaboration with the existing network licensees, given that we have a critical role to play due to our detailed knowledge and history of the performance and condition of assets. Such local network knowledge as well as existing relationships with local communities, key stakeholders and customers should not be underestimated in delivering network planning responsibilities. We believe that this should also be considered alongside any performance metric undertaken by Ofgem.

We believe that industry stakeholders and external parties must be able to input into the performance metrics undertaken by Ofgem to raise any concerns over the performance of the FSO. Similar to the existing performance evaluation of the ESO, we believe continued, meaningful input from stakeholders will help Ofgem in continuing to shape the FSO while also addressing network operator concerns once the FSO is fully operational. With the only real incentive sitting behind the FSO to deliver on its objectives being risks to reputational damage and the calculation of remuneration for senior staff, network operators will need to have their concerns factored into the amalgamation of the performance review and subsequent outcome.

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

We welcome and support Ofgem's implementation approach, especially the commitment to ensuring industry have sufficient opportunity to input and influence major changes to regulatory approaches, given the importance of the FSO to the sector. Generally, we are supportive of the timeline of changes and the different phases mentioned in the consultation and welcome Ofgem to consider the points raised above in continuing to develop the regulatory framework for the FSO.

We are concerned about the appearance of potential conflicts of interest where there is one sole entity, such as the FSO, who sets the strategic direction of the codes that govern the industry and can set the market conditions, as well as operating the network. We believe that Ofgem should consider how to ensure that stakeholder expertise and skills, as well as any concerns and feedback, are factored into the decision making of the FSO when setting the strategic direction of codes, setting market conditions, and planning the network. We would welcome Ofgem's view on how it is intending to manage these conflicts.