

Future System Operation Team
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2 February 2024

Consultation on the policy direction for the Future System Operator's regulatory framework

Dear Future System Operator Team,

NGT welcomes the creation of the FSO into the energy sector and has been working proactively with DESNZ, Ofgem and ESO in order to ensure that FSO is a success from Day 1.

----- we have been instrumental in developing the network analysis and planning capability via a tailored training programme and have helped shape the Office of Resilience and Emergency Management (OREM) function together with building the knowledge of the team working in this area.

It is essential that the FSO is seen as an independent whole energy system body and that it's regulatory and financial framework is created to ensure this is delivered. The nature of the FSO in having direct and operational management of the electricity system as well as a proactive process and advisory role across the whole energy system needs to be reflected in the framework that is adopted to ensure that these functions are operated and controlled independently within FSO so that industry can have confidence that FSO is demonstrably delivering against it's primary and secondary duties.

We have addressed the specific questions in this consultation below but we believe the principles set out above need to be incorporated into any framework or objectives that the FSO needs to comply with irrespective of whether there are financial incentives as part of the framework or not.

The FSO must be held to account to be demonstrably delivering the right outcomes for consumers based on an energy secure, affordable transition to Net Zero across the whole energy system.

The consultation references, in 1.6, the FSO having responsibilities across both electricity and gas, however we would consider that they have responsibilities across the whole energy system from Day 1 given the recent developments in the role of hydrogen in the energy transition.

Whilst it is useful for Ofgem and FSO to consider building on existing ESO arrangements, and it is likely to be efficient to do so, it is essential that the FSO is seen as a new and independent organisation and not ESO taking on new accountabilities/responsibilities. To that end it must have fresh thinking and new approaches, not something based on electricity modified to accommodate other energy vectors. Failing to start off in this way will compromise the credibility of the FSO within the industry and make it harder to achieve the outcomes the whole industry, and the wider economy is looking to deliver.

We hope that this response is helpful to Ofgem's thinking on this important topic. If you have any questions or comments, please do not hesitate to contact Paul Sullivan, Head of System Capability and Risk (paul.j.sullivan@nationalgas.com) or Phil Lucas, Senior Codes Change Lead (phil.lucas@nationalgas.com).

Yours sincerely,

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Annex: Consultation question responses

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

We agree with Ofgem that a financial framework based on a not-for profit principle is appropriate for the public based, policy/advisory body that the FSO needs to become.

However there remain questions as to whether this structure can effectively work for all aspects of the FSO organisation such as the System Operator function within FSO. We would question whether a reputational incentive alone can drive the performance and efficiency required in an organisation that needs to be active in a commercial market, where it is not exposed to the direct consequences of its actions.

2.6 – We support the principle of the use of a ‘100% fast money approach’ for the recovery of the gas related FSO functions. We look forward to working with Ofgem on the development of how this cost recovery will operate for a timely charge and reconciliation of the FSO gas related costs through NTS Transportation charges. We anticipate more detail will be set out in the forthcoming statutory consultation.

2.7 – It is important to consider carefully how areas such as value for money and efficiency of the FSO’s actions or decisions are taken, given the strategic long term nature of these and the impacts that are likely to be felt across all energy system and industry stakeholders. What appears to be an efficient decision in one timeframe for one energy vector may create a significant and potentially detrimental impact in another.

2.10 – There is a focus on ‘maximising consumer benefits’ which is a principle we agree should be at the centre of the framework for the FSO, however it is essential that the wider industry engages on and understands what constitutes a consumer benefit and how they will be measured in terms of the responsibilities the FSO has. For instance, the benefit that the consumer has of a secure gas supply to heat their homes and indirectly to provide electricity via a CCGT may not be valued by a consumer until decisions conspire to interrupt that supply, but this could have been caused by decisions a decade previously and are by then irreversible.

2.11 – IT spend can be considerable and whilst over a shorter time period than network assets, would still benefit from smoothing across a time period that limits the exposure to consumers in any one year. Additionally, the mechanism that will be used to apportion costs between energy vectors of FSO spend on central systems etc. should be considered as part of this framework.

2.12 – The concept of a publicly owned, not for profit body having a performance related pay incentive where the demonstrable efficiencies will likely be realised in other organisations is difficult to support.

2.14 – It is important to note that the costs being incurred by the FSO in its gas related activities will all be incremental to today as the activities are necessarily duplicated with NGT. Therefore to show efficiencies against the cost to consumers it will be essential for the FSO to deliver financial benefits to consumers in excess of their costs of operating within the gas sector.

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?

Objectives

We agree with the objectives as set out in 3.1 and these are appropriately at a high, strategic level to provide direction to FSO in order to shape the culture of the organisation and to set expectations in the wider industry on what will be driving the management of the organisation.

In setting these, it is also essential to contemplate the specific metrics that could be used to measure the effectiveness of the FSO's actual delivery/benefit. Metrics such as measurable outcomes, cost and cost reduction to consumer, efficiency of outcome delivered, effectiveness of outcome delivered, decisions delivered on time etc.. These would give a real sense of the efficiency and effectiveness of the organisation and the benefit it may bring to the industry and ultimately consumers.

It is also important to track and report on areas where FSOs advisory or decision making roles impact on the actual delivery of infrastructure, market arrangements, contract provisions etc. where these are delivered by parties other than the FSO, i.e. energy security obligations within gas.

Case For Change

3.8 – the measurement of delivery against strategic aims is difficult to achieve, and whilst it will be fundamental to the role of the FSO the majority of their responsibilities in this area will be actually achieved/discharged by other organisations and so the FSOs role is delivering those strategic aims will be difficult to specifically assess and quantify.

It is unclear how the changes proposed to the regulatory framework will be applied and interpreted in practice across the diverse parts of the FSO organisation, such as gas strategic network planning and electricity control centre operations.

Potential Future Options

3.9 – it is unclear how the changes proposed to the regulatory framework will be applied and interpreted in practice across the diverse parts of the FSO organisation, such as gas strategic network planning and electricity control centre operations.

3.20 – the formation of the business plan, and the framework that guides it, must be demonstrably energy agnostic not being based on existing arrangements for either gas or electricity but fit for purpose for a whole energy organisation.

In some areas the FSO statutory duties will actually be delivered by other organisations, the FSO role will be to enable that organisation to deliver the necessary outcomes. This is an area that will be difficult to measure in a timely way given that the impact of the wrong or no decision may not be felt for many years.

3.26 – Whilst we understand it is common place to reflect market based metrics in the pay of senior members of publicly owned organisations it is not clear whether this would be the case for all employees of the FSO. It is important that the framework establishes whether the remuneration of all employees will be based on the commercial market rates for that work or be based on public policy guidance on pay and conditions.

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

3.9 – It is important that the whole industry has a stake in shaping and developing the framework for the FSO given the wide impact that is envisaged for it. To this end we feel it is essential that there is a role on the Board of the FSO for representatives from each sector that the FSO is intended to interact with, including – electricity distribution, electricity transmission, gas distribution, gas transmission and hydrogen. The role could be similar to a Sufficiently Independent Director (SID) with the representatives acting independently of their specific organisation or interests, this would ensure that the FSO's responsibilities and their discharge of them is appropriately scrutinised by the most senior members of the organisation.

3.23 – The FSO is not a standalone organisation, in order to deliver what is required by the consumer and wider industry it is essential that the FSO and other industry stakeholders work closely and all decisions and recommendations either made or not made are transparent and open to scrutiny and challenge and review. This is especially important where the action or inaction taken by FSO could lead to another organisation failing to meet its obligation at some point i.e. security of supply obligation for gas.

In this regard it is difficult to see how Ofgem or the industry measure the performance of the FSO against its Primary and Secondary Duties when these are effectively delivered by other organisations, and so what looks like an efficient decision taken by FSO in the short term leads to a failure for the industry to meet its obligations at a later date.

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

The proposal to phase the changes and evolve the regulatory framework appears sensible given the relative short timescales to prepare the FSO for Day 1 operations.

In terms of the interaction with the wider industry, specifically gas, the next price control period will commence in April 26 and the ability for the FSO to be consulted and to take an active role in its development or evaluation is very limited. However, it is essential for the stability of the regulatory regime for gas and the delivery of the business plans that the FSO not seek to reopen the arrangements once established although we do recognise that Ofgem may seek to refer specific investment proposals to them as they are brought forward.