
ADE Response Ofgem Consultation on the policy direction for the Future System Operator's regulatory framework 2 February 24

Context

The ADE welcomes the opportunity to respond to Ofgem's Consultation on the policy direction for the Future System Operator's regulatory framework.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side flexibility and storage, industrial energy including combined heat and power, heat networks and energy efficiency.

Summary

We appreciate that Ofgem acknowledges that due to the very different nature of the FSO, "there is a strong case for a full review of the regulatory approaches we currently apply to the ESO under the RIIO-2 framework". However, we're not sure such a review has been adequately evidenced to make "a good case for moving towards a lighter touch regulatory approach for the FSO". We have not yet been communicated with on any such review nor seen any public conferences, webinars or workshops on the issues that demand fundamental change as the ESO becomes the FSO/NESO. For the purposes of this consultation we will continue to use FSO.

We consider this document is far too light on detail on how Ofgem actually seeks to drive the cultural change necessary for the FSO to fulfil its statutory obligations.

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

The ADE agrees with this approach noting the massive changes this demands of other forms of regulation. However, it is important to note that although capital expenditure will be "predominantly on IT system" this does not mean that requires less attention or oversight than other forms of capex. The IT transformation that the FSO will have to undertake is unlike anything in the organisation's history and needs to be adequately regulated for, including accounting for long-term spending projects.

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?

With Ofgem losing their most powerful regulatory tool - finance, we do not consider adequate thought has been evidenced as to its replacement. Ofgem places a lot of confidence in the level of change that will flow simply from being a public body with statutory obligations. However, that alone does not adequately reflect the wholesale transition the ESO is making from a private company to a public body. This transition necessitates greater demands on transparency, accountability, and the recognition of the market power it holds. Furthermore, as seen with state-owned SOs in other jurisdictions, the fear of reputational damage has not always mitigated the risks Ofgem points to. We must not simply wait for these problems to continue and then decide how regulatory improvements can be made to meet them. Ofgem must spell out how performance against their statutory obligations will be measured. Consumer interest will no longer simply be measured on security of supply at lowest cost, it will also depend on

consumers own ability to participate in securing supply and the interest they have in moving towards low carbon forms of balancing. It has not yet been made clear how such metrics will be measured against senior management's performance.

FSO regulation must aim to improve the areas of persistent industry and regulatory concern, namely initiating a change of culture rather than just a change of name. Reforming how ENCC relates and interacts with the rest of the ESO is one such cultural change.

While other areas of ESO have begun taking a more forward-facing approach during RIIO-2, issues with control room systems, digitalisation, and transparency have made reformative change impossible. Furthermore, when 'transparency' events are held, they are hallmarked by persistent pre-scripted broad responses that do not address the detail of the question asked. Likewise, control room often cite their core licence obligation as balancing the grid efficiently and economically and that any other obligations are peripheral. This could be taken to mean that control room do not consider the duty to treat all assets fairly or to prove that prima facie discriminatory actions are justified, are part of their licence obligations. It is possible that a further regulation may be needed to ensure the independent oversight of the ENCC.

Finally, we cannot simply forget the summary of the Zuhlke report, published as an Appendix of Ofgem's RIIO-2 BP 2 Draft Determinations. Not only were repeated calls made by ADE for Ofgem and ESO to hold a joint public session to discuss these results for those stakeholders perhaps not able to dedicate time to perusing regulatory appendices, ESO representatives were questioned about the report at a Parliamentary Select Committee where the only answer given was that they dispute some of the findings. For an independent audit to conclude half a billion pounds of investment raised concerns and that "Future System Operator needs are at risk" without any further public follow-up from ESO or the regulator hardly instils faith in the transparency and accountability mechanisms in place. Therefore, we strongly reiterate our calls for a public session to examine the audit in detail and allow the ESO to address what findings they dispute, rather than stakeholders having to root through another set of appendices.

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

Under the objectives for performance regulation of the FSO, Ofgem cites proportionality which "involves a level of oversight and burden appropriate to the FSO's organisational set-up." The implementation of proportionality testing within ESO and clear burdens of proof is something ADE has repeatedly advocated for, see our response to Ofgem's Draft FSO Licences Consultation last year [or our recent blog](#) on the subject. Ofgem should clearly set out that the burden for proving that an FSO design or decision is necessary and proportionate is based squarely on the FSO, not industry. In other words, any design or procurement decisions that appear prima facie discriminatory should have a presumption of invalidity for the FSO to rebut, rather than requiring stakeholders to prove why decisions are wrong. Ofgem should, outline a proportionality test for the FSO to satisfy in cases of such conflicts.

Building on the above, set out that control room incapacabilities, as opposed to system or energy needs, are not a justifiable reason for discriminatory treatment of assets in the design, procurement or decision-making on balancing services. As just one example, ESO introduced the design for Balancing Reserve and its discriminatory minimum thresholds without consultation which clearly took a significant amount of resource from within ESO to design. It

was then incumbent upon industry to invest a vast amount of time objecting to the proposal that was ultimately rejected by Ofgem. This endeavour cannot be said to have been in consumer's best interests and demonstrate a culture of ESO travelling very far down a road on the presumption that they are right, without any external scrutiny.

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

While we agree with the timelines in principle, again we do not believe enough emphasis has been given by Ofgem or FSO to date of the embedded cultural shifts that will be needed as they become a public body. Such considerations should be at the forefront of discussions this year and we recommend Ofgem hold a series of online, interactive workshops, as has been done by the team working on the flexibility digital infrastructure, to present on proposals and gather feedback.

None of this feedback is new and we have consistently flagged our concerns to Ofgem over the RIIO-2 period, through consultations proposing to give the FSO more duties before it is formed and within FSO consultations themselves.

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