



Via email:
FSO@OFGEM.gov.uk

17th January 2024

Email: Tom.Steward@RWE.com

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

Dear David Beaumont

RWE is a leading global energy player, with a 38 GW global generating capacity worldwide, and a clear target: to get to net zero by 2040. With its new strategy 'Growing Green' (announced in November 2021) RWE expects to invest €50 billion gross in its core business globally - an average of €5 billion gross each year for offshore and onshore wind, solar, batteries, flexible generation and hydrogen.

RWE is the UK's largest power producer, accounting for around 15% of all electricity generated across a portfolio of onshore wind, offshore wind, hydro, biomass and gas, amounting to over 10 GW pro rata¹ (12 GW installed capacity) - enough to power over 10 million UK homes.

RWE is also one of the largest renewables generators in the UK, with a combined installed capacity of over 2.79 GW (pro rata) (4.8 GW installed capacity) across our onshore wind, offshore wind, hydro and biomass assets. In addition to its growing renewables portfolio, RWE operates around 7GW of modern and efficient gas-fired capacity in the UK, making us one of the largest providers of firm flexible generation, which is crucial for security of supply.

Overall, and including its committed investments in projects already under construction, RWE expects to invest up to £15 billion in new green technologies and infrastructure in the UK by 2030.

RWE is committed to supporting the communities in which we operate and has a long history of listening to local people and other stakeholders, and building flexible community funds that can respond to local needs. As of January this year, RWE's wind farm projects across the UK have invested more than £33 million into

¹ Pro-rata – based on equity share

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RWE Renewables UK Limited: Registered in England and Wales no. 03758404

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community benefit funds with local grass roots decision making. This is set to grow by more than £4.5 million per annum from our operating portfolio alone.

Thank you for the opportunity to respond to the consultation on Policy direction for the National Energy System Operator's regulatory framework. The NESO will be central to the cost-efficient delivery of Net Zero and consequentially the regulatory regime which surrounds it requires careful consideration.

Overview

- Whilst we support removal of fines as a route to ensure compliance, given the change of ownership model, it is essential that Ofgem has the necessary levers to hold the NESO to account. The current reliance upon "reputational levers" requires more clarity. We support the proposed direct link between regulation and senior staff bonuses..
- We believe requiring senior NESO staff to appear before the Energy Security and Net Zero Select Committee to discuss performance would be another useful route to ensuring high standards of delivery from the NESO.
- We believe a "fast money" approach to bill funding is appropriate, but would welcome greater clarity regarding the financial relationship between the NESO and the Government. It is essential that independence from government is maintained.
- We believe transparency should be a core facet of the NESO's operations – in particular to ensure that industry participants are able to engage with and comment upon the assumptions underlying the Strategic Spatial Energy Plan (SSEP) and advice given to government.
- We note that the regulation of the NESO is reliant upon the Strategy and Policy Statement. The SPS should therefore be published as soon as possible, ahead of NESO Day One.
- Whilst we understand the Government's eagerness to progress development of the SSEP, commissioning such a plan before the NESO has been formed, or the relevant regulatory framework has been fully developed, creates significant unnecessary risk. Given the value of *independent* system planning, we would welcome further clarity around this point.

I hope you find the below response useful, if you have any questions or would like to discuss any of our response further, please do not hesitate to contact me.

Yours sincerely,

Dr. Tom Steward

Senior Regulatory Affairs Manager
RWE



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

We support the proposal to operate the NESO as a not-for-profit entity. Given the current expected scope of work of the NESO, a fast-money approach appears logical. This should be kept under review however, if in future a significant financial outlay on a new piece of infrastructure is required, the impact on consumer bills of collecting this within one year should be considered.

It appears the Government is proposing to offer funding to the NESO to ensure it is able to carry sufficient levels of working capital – we would welcome clarity on this point.

We support the steps being taken in the financial framework to ensure the NESO's independence from Government. We would welcome greater clarity on the mechanism by which new spending will be approved by Ofgem, which then requires the NESO to request additional working capital funding from Government. Ofgem's independence from Government is well-established, and therefore it would not be appropriate for Government to have a role in assessing the NESO's spending plans, or to have power to refuse a NESO request for working capital for projects that have been approved by Ofgem.

Assuming we are correct in understanding that Government will fund the working capital requirements of the NESO, it appears logical that the NESO does not need private borrowing powers or a credit rating. However, if at any stage the NESO is to act as a counterparty to private companies within the sector, it is essential that it has a sufficiently robust credit rating, or is able to offer government-backed letters of guarantee, to give industry members sufficient levels of financial certainty that the NESO will be able to meet its financial obligations.

We agree that financial penalties or incentives on the NESO would not be appropriate as these would be passed directly through to consumers. However, we would welcome more detail on how "reputational incentives" are intended to work. It is essential that the NESO can be held to account, and that the regulator has meaningful powers to ensure compliance. It is also important that the framework by which this will be achieved is clear to all parties, and is made public. We note that Ofgem has not to date had to develop expertise in ensuring compliance without the powers to levy significant fines – this may require developing of new skills/approach within the regulator.

We propose that in addition to ongoing scrutiny by Ofgem, the NESO's senior staff should appear before the ESNZ Select Committee on an annual basis to answer questions about its performance over the previous year. This should be preceded each year by a call-for-evidence by the Select Committee, to allow the industry to raise concerns and highlight successes that can then be put to the NESO's senior staff by the Committee. If ever significant shortcomings by the NESO are identified, it appears logical that the ESNZ Committee should be able to highlight this to the



Secretary of State (as the sole NESO shareholder) to consider and respond to as appropriate. Such recommendations could include the need for further formal investigation (with possible further consequences for senior staff – as set out in the consultation).

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 & Case for Change

We support the objectives set out for the regulation of the NESO, and we are in agreement of the case for change of the regulatory regime surrounding the NESO – the publicly owned nature of the organisation, and the increased guiding role in the energy system imply the regulatory framework which was designed for the present-day ESO is not likely to be fit for purpose.

We are unclear therefore of the value of the analysis set out on page 14 which appears to, at least in part, assess the suitability of the current regulatory regime as it applies to the ESO. For example, Accountability is given a ‘green’ RAG status on the basis there are clear formal processes for assessing performance of the ESO and dealing with non-compliance. However, given the significantly broader remit of the NESO, it is not clear that the current measures of performance continue to be appropriate, and (as noted in consultation) the current financial penalties levied for non-compliance are unlikely to be appropriate for a publicly owned company.

Similarly – the ESO has achieved an “Amber” against high-performance, however given the significantly increased expectations of the NESO over and above the responsibilities of the ESO, it is not clear that this assessment is relevant. Indeed one could argue that there is increased risk that the NESO’s performance may lag behind the ESO’s, relative to objectives, given the sudden increase in responsibilities of the new institution.

We would therefore welcome a new assessment of how the current ESO, and the associated regulatory regime, would be assessed against the new objectives of the NESO – this could help to highlight areas which require particular development.

With regard to coordination, we agree that there is more to be done to ensure the activities of the NESO are aligned with those of the Government. More also must be done to ensure there is clarity regarding the interaction of different responsibilities of the NESO itself – in particular the relationship between the SSEP and the CSNP.

We are strongly supportive of the need for transparency, and believe the new role of the NESO will require degrees of greater transparency than is currently displayed by the ESO. For example, in the role of advice-giving to government, it is essential that processes are developed to allow other industry participants visibility of such advice.



In addition, under the development of the SSEP, it is crucial that industry are able to study and comment upon the assumptions that underpin the SSEP's development.

We agree with the assessment that the current RIIO business plan process is not likely to be appropriate for a not-for-profit organisation, and that a less granular process of assessment of expenditure is likely to be more proportionate. Although an equal degree of care must be taken with bill payers' money, the lack of profit motive reduces the incentive for the NESO to leverage the informational asymmetry between the regulator and the system operator. Measures within the regulatory regime intended to address this information asymmetry may therefore be scaled back.

In addition to scrutiny by the ESNZ Select Committee (proposed above), and reputational incentives, we support the proposed linking of regulation and senior staff remuneration..

The SPS & NESO Regulatory Framework

Whilst we support the NESO being subject to the SPS, we note that at time of writing, the SPS has only been released in draft form, and there is no publicly confirmed date for its final publication. It is essential that this is published as soon as possible, ahead of NESO Day One. We would also welcome clarity how this will be kept up to date with changes in government policy.

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

Regular public assessment of NESO activity appears appropriate. Although the profit motive is removed, cultural change is a lengthy process, and therefore it is right that there remains a high degree of scrutiny both over spending and other activities. We strongly support the proposal for stakeholders to be able to comment on the performance of the NESO, and suggest this be part of the same process as the ongoing public assessment, to allow the NESO to be challenged or congratulated, as appropriate in direct response to the feedback of industry participants.

As set out above, this public assessment could take the form of a standing requirement for senior NESO staff to appear before the ESNZ Select Committee, preceded by a call for input through which industry participants can offer their insight into the NESO's successes and opportunities for improvement. Findings from the ESNZ committee could then be passed onto the Secretary of State, as the sole shareholder, to consider and respond to. Independent assessment of the NESO's performance is essential, and this should be foundational to how the incentives are set, and performance evaluated.



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

We have concerns that some responsibilities are being placed upon the ESO in anticipation of it becoming the NESO, such as the commissioning of the SSEP (expected in Q1 2024). The SSEP has the potential to have a profound effect (either positive or negative) on investor confidence, and consequently the cost-efficient transition to Net Zero. Whilst we understand the Government's eagerness to progress development of the SSEP, commissioning such a plan before the NESO has been formed, or the relevant regulatory framework has been fully developed, creates significant unnecessary risk. The need for *independent* strategic system planning was a foundational part of the case for delivery of the NESO. If it is not clear therefore why development by a private company is considered appropriate, particularly when the wider regulatory framework is not intended to be delivered until April 2025. This is compounded by a lack of clarity regarding the objectives and scope of the SSEP.