

Email to:

FSO@ofgem.gov.uk

Dear David Beaumont,

Response to consultation on the policy direction for the Future System Operator's regulatory framework

Scottish Renewables is the voice of Scotland's renewable energy industry. The sectors we represent deliver investment, jobs and social benefits and reduce the carbon emissions which cause climate change. Our 360-plus members work across all renewable energy technologies, in Scotland, the UK, Europe and around the world. In representing them, we aim to lead and inform the debate on how the growth of renewable energy can help sustainably heat and power Scotland's homes and businesses.

Scottish Renewables welcomes the opportunity to respond to this consultation on the policy direction for the Future System Operator's regulatory framework.

We would like to draw attention to a range of issues that we address below:

- We support the proposal to operate the FSO as a not-for-profit entity. Given the current expected scope of work of the FSO, a fast-money approach is logical.
- We support the steps being taken in the financial framework to ensure the FSO's independence from Government. We would welcome greater clarity on the mechanism by which new spending will be approved by Ofgem then requires the FSO to request additional working capital funding from the Government.
- We agree that financial penalties or incentives on the FSO 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.
- We support the objectives set out for the regulation of the FSO, and we agree with the case for change of the regulatory regime surrounding the FSO.

Finally, we are strongly supportive of the need for transparency, we believe the new role of the FSO will require degrees of greater transparency than is currently displayed by the ESO.

Please find our response to the consultation questions below, where we have provided more detail on all these highlighted issues. Scottish Renewables and its members would be keen to engage further with this agenda and would be happy to discuss our response in more detail.

Yours sincerely,

Stephen McKellar

Stephen McKellar
Senior Policy Manager | Grid & Systems
smckellar@scottishrenewables.com
Scottish Renewables

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

We support the proposal to operate the FSO as a not-for-profit entity.

Given the current expected scope of work of the FSO, a fast-money approach is logical. This should be kept under review – for example, if at any stage 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 FSO to ensure it can 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 FSO's independence from Government. We would welcome greater clarity on the mechanism by which new spending will be approved by Ofgem then requires the FSO to request additional working capital funding from the Government. Ofgem's independence from the Government is well-established, and therefore it would not be appropriate for the Government to have a part in assessing the FSO's spending plans, or to have power to refuse an FSO request for working capital for projects that have been approved by Ofgem.

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

We agree that financial penalties or incentives on the FSO 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 FSO can be held to account, and that the regulator has meaningful powers to ensure compliance. 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 new skills/approaches within the regulator.

We propose that in addition to ongoing scrutiny by Ofgem, the FSO's senior staff should appear before the DESNZ 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, to allow the industry to raise concerns and highlight successes that can then be put to the FSO's senior staff by the committee. If ever significant shortcomings by the FSO are identified, the

DESNZ committee should be able to recommend to the Secretary of State (as the sole FSO shareholder) the removal of relevant senior FSO staff.

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 FSO, and we agree with the case for change of the regulatory regime surrounding the FSO – 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 ESO is not likely to be fit for purpose.

We are unclear 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 the performance of the ESO and dealing with non-compliance. However given the significantly broader remit of the FSO, it is not clear that the current measures of performance continue to be appropriate, and (as noted in the 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 FSO over and above the responsibilities of the ESO, it is not clear that this is a valid assessment. Indeed, one could argue that it would be expected for the FSO's performance to lag behind the ESO's, relative to objectives, given the sudden increase in responsibilities of the institution.

Concerning coordination, we agree that there is more to be done to ensure the activities of the FSO 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 FSO itself - in particular the relationship between the Strategic Spatial Energy Plan (SSEP) and the Centralised Strategic Network Plan (CSNP).

We are strongly supportive of the need for transparency, we believe the new role of the FSO will require degrees of greater transparency than is currently displayed by the ESO. For example, in the role of advice-giving to the Government, it is essential processes are developed to allow other industry participants visibility of such advice. In addition, under the development of the SSEP, the industry must be able to study and critique 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 impact of 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 the absence of financial penalties for non-compliance, we believe it is appropriate for Ofgem to have the power to make recommendations to the Secretary of State (as the sole shareholder of the FSO) regarding the position of the Chair of the FSO Board and other senior FSO staff. Whilst it is appropriate that the remuneration committee is independent of senior FSO staff, giving a senior Ofgem representative a seat on the remuneration committee, with the power of Veto (exercisable only in response to significant breaches of licence requirements), would be appropriate.

The SPS & FSO Regulatory Framework

Whilst we support the FSO being subject to the SPS, at this time it would not be appropriate to rely on the SPS as a fundamental pillar of the FSO regulatory regime. At the 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 also not clear if the SPS will continue to be valid following a general election. Both mean that there may be a significant regulatory vacuum for the FSO either on Day One or shortly afterwards. The regulatory regime of the FSO must therefore be robust without the publication of the SPS – for example with “fallback objectives” in the absence of an SPS.

We propose such appropriate fallback objectives (which could be superseded by the presence of a valid SPS) could be:

- The FSO will be responsible for supporting a cost-efficient pathway to net-zero and meeting interim carbon budgets. Cost efficiency will be taken over the medium to long-term, recognising that short-term expenditure may be necessary to deliver a lower cost overall.
- The FSO will look beyond cost in its decision-making to consider a wide range of issues including but not limited to environmental impact; impact on energy security (including resilience to extreme weather events) visual impact; CO₂ emissions; non-CO₂ emissions; job creation; investor confidence, economic growth etc.
- The FSO will support competition and market-based approaches in so far as this leads to the most efficient outcomes for the energy system.

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

The regular public assessment of FSO activity appears appropriate, at least in the short-medium term. 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 for both overspending and other activities. We strongly support the proposal for stakeholders to be able to comment on the performance of the FSO and suggest this be part of the same process as the ongoing public assessment, to allow the FSO to be challenged or congratulated, as appropriate in direct response to the feedback of industry participants.

This public assessment could take the form of a standing requirement for senior FSO staff to appear before the DESNZ Committee, preceded by a call for input through which industry participants can offer their insight into the FSO's successes and opportunities for improvement. Findings from the DESNZ committee could then be passed onto the Secretary of State, as the sole shareholder, to consider.

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 FSO, 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 the development of the SSEP, commissioning such a plan before the FSO 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 the delivery of the FSO. It is not clear 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.