



David Beaumont
ESO Regulation
Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU

SSE plc
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

martin.namor@sse.com

By email to FSO@ofgem.gov.uk

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Dear David

Consultation on Associated Documents to the proposed NESO licences - regulatory framework documents

On behalf of the SSE Group, I welcome the opportunity to respond to Ofgem's consultation on its proposed modifications to some of the regulatory documents currently associated to the existing Electricity System Operator (ESO) licence to reflect the imminent establishment of the National Energy System Operator (NESO) and its two licences covering its roles as Electricity System Operator (ESO) and Gas System Planner (GSP).

The SSE Group is a FTSE-100 company headquartered in Perth, Scotland, with interests across the UK and Ireland, Europe, Asia Pacific, and North America. We are one of the largest electricity network companies in GB and a leading generator of renewable electricity in GB and Ireland. We develop, build, own, and operate the low carbon infrastructure that is essential to support the transition to net zero. This includes electricity transmission and distribution networks; offshore and onshore wind; hydro and pumped storage; solar and batteries; flexible and efficient thermal generation (including hydrogen and carbon capture and storage). We also provide energy products and services to business customers.

We welcome the opportunity to provide our views on Ofgem's proposals for some of the key associated documents to NESO's new licences, and more broadly on the proposed regulatory framework for NESO, as we consider a successful implementation of NESO to be of fundamental importance to the energy transition and the achievement of net zero targets.

We note and support Ofgem's intention to introduce changes to the existing regulatory framework currently in place for the ESO in a phased way that reflects the key milestones of the transition from ESO to NESO. Since we are now well over halfway through the current two-year business plan period for the ESO (BP2, covering April 2023 to March 2025), with NESO expected to be officially launched when there will be only a few months left in the current period, we agree that only critical changes should be introduced before NESO Day 1 and apply during the final months of BP2.

Our primary focus remains on the enduring regulatory framework that will apply to NESO once the transition from ESO to NESO has been completed. Therefore, we are keen to hear about Ofgem's proposals for any

further and more substantial changes that will apply from April 2025 (following the end of BP2) and from April 2026 (following the end of the current RII0-2 price controls for electricity and gas transmission owners).

We welcome Ofgem's indication, in the consultation document, that further stakeholder engagement will take place from summer 2024 to discuss the enduring regulatory framework and look forward to the opportunity to provide our views as part of that process. We would encourage Ofgem to set out and publish a clear timeline for developing and consulting on these further changes, to provide transparency to the industry and ensure that all interested stakeholders have an opportunity to engage in a meaningful way.

The initial changes proposed as part of this consultation focus on three Associated Documents (ADs) that are being updated under the two new licences proposed for NESO¹:

- The ISOP Roles Guidance Document (RGD).
- The ISOP Reporting and Incentives Arrangements Governance Document (RIAGD).
- The FSO Transition Funding Governance Document (TFGD).

ISOP Roles Guidance Document

We note that Ofgem's proposed changes to the RGD fall into two categories:

1. Targeted changes to the expectations set for the three existing BP2 roles² to reflect the transition from ESO to NESO and incorporate those new NESO activities that are already closely aligned with the three existing roles, such as Centralised Strategic Network Planning (CSNP) and Future Energy Pathways (FEP).
2. The introduction of a new chapter (Chapter 5) covering Ofgem's key expectations for NESO's implementation (referred to as 'FSO Transition Activities') and the delivery of those new roles and activities that are less closely aligned with the three existing roles; for example, Strategic Spatial Energy Planning (SSEP) and Regional Energy System Planning (RESP).

We agree with Ofgem's assessment that this seems a pragmatic and proportionate way of integrating new expectations within BP2 when there are only a few months left before the end of the current business plan period; and we note that Ofgem intends to consider further the best way of setting consolidated expectations across all of NESO's responsibilities as part of the development of the enduring regulatory framework that will apply from April 2025. As suggested above, Ofgem should ensure that industry stakeholders are given ample opportunity to input into that process.

We support the targeted changes to the expectations set for the three existing roles, as integrated with the closely aligned new NESO roles, and have no further comments on this category of proposed changes to the RGD.

¹ We note that three different terms are being used to refer to the new system operator: National Energy System Operator (NESO, its chosen name); Independent System Operator and Planner (ISOP, as identified in the Energy Act 2023); and Future System Operator (FSO, its original denomination during earlier policy development). Whilst the Associated Documents covered in this consultation refer to either ISOP or FSO, we use the terms NESO throughout our response for consistency. We also use acronyms when referring to the three ADs for ease of reference.

² Role 1: Control centre operations; Role 2: Market development and transactions; Role 3: System insight, strategic planning, and network development.

We note that Chapter 5, covering Ofgem's expectations for NESO's implementation and the delivery of those new roles that are less or not aligned with the three existing roles, is very brief, especially when compared to Chapters 2-4, which describe in much greater detail the expectations for the three existing roles.

Whilst we appreciate that this document, in its current form, would only apply for the few months between NESO Day 1 and the end of March 2025, those months will be critical for a successful implementation of NESO as a leading organisation within the energy sector. Therefore, we would suggest that Ofgem should set out its expectations in greater detail at this stage to allow both itself and stakeholders to scrutinise closely NESO's performance, especially in setting themselves up as a new organisation, at such a critical time for the industry.

Some of the expectations set out in Chapter 5 seems too high-level and generic to allow Ofgem and stakeholders to determine objectively whether and to what extent those expectations have been met by NESO. For example, on the topic of value for money, the only expectation is that NESO should "*provide value for money to consumers through the delivery of FSO Transition Activities and new ISOP roles and responsibilities*". There is no indication of how 'value for money' should be interpreted in this context, measured, and benchmarked against Ofgem's expectations.

Overall, we would encourage Ofgem to expand Chapter 5 ahead of Day 1, rather than waiting for the next round of updates ahead of April 2025, to define in greater detail its expectations in relation to the implementation of NESO as an organisation and the introduction of its new roles.

ISOP Reporting and Incentives Arrangements Governance Document

We agree that, with NESO transitioning from a private to a public organisation, no organisational-level financial incentives should apply, as the cost of both financial rewards and penalties would ultimately be borne by consumers. Therefore, we support the removal from the RIAGD of the sections relating to the calculation of financial penalties and rewards and the intention to replace financial incentives with reputational incentives between NESO Day 1 and the end of BP2.

However, in the consultation and draft RIAGD there is limited detail on these reputational incentives and explanation of how they would drive good performance from NESO. Ofgem states it is "*confident that the combination of our continued public assessment of NESO performance and our approval of NESO's staff remuneration policy will provide robust incentives on NESO from Day 1*". In our view, there is no guarantee that Ofgem's assessment of NESO's performance and oversight over its remuneration policy will be sufficient to deliver good levels of performance.

In relation to staff remuneration, Ofgem proposes that NESO will be required to follow a policy, approved by Ofgem, which outlines how Ofgem's assessment of NESO's performance will be factored into its senior-staff level financial incentives. We support this proposal. In addition, we would suggest that, for any financial incentives applying to non-senior staff, these should also be linked to Ofgem's assessment of NESO's performance, as the overall performance will be a function of the contribution of the entire workforce throughout the organisation.

More in general, in the absence of organisation-level financial incentives, it is essential that Ofgem is equipped with a suite of suitable alternatives to ensure that NESO is held fully accountable and good performance is

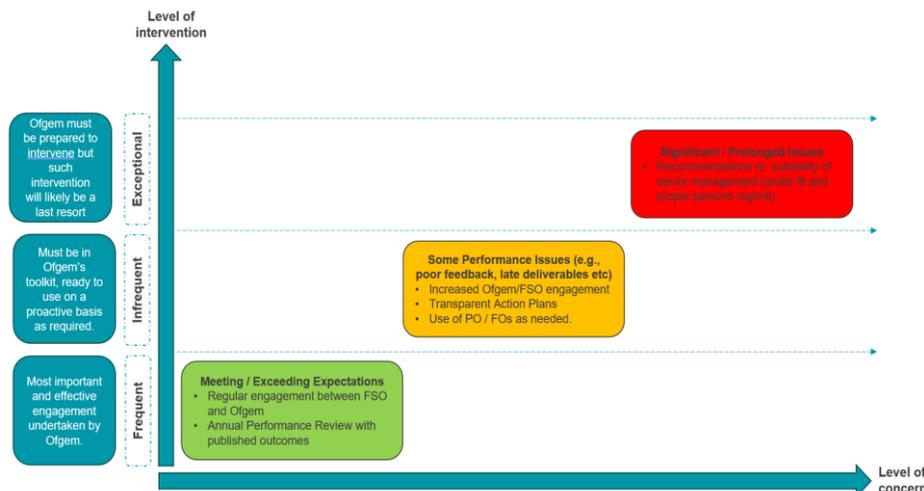
incentivised. This should include Ofgem’s proposed periodic performance reviews and staff-level incentives, but also other regulatory tools, for example:

- Provisional and Final Orders (POs / FOs) requiring NESO to publish and commit to appropriate action plans to address potential or actual underperformance.
- The use of Fit and Proper Person (FPP) tests to ensure that NESO’s senior management has the right skillset to lead the organisation (although we would recommend a review of the current FPP regime to address existing weaknesses, for example in relation to the notification of personnel changes).

In our view, POs, FOs, and interventions under the FPP regime, should all be part of Ofgem’s regulatory toolkit. However, we recognise that these would be serious interventions, which should only be deployed on an infrequent or exceptional basis, and only once a certain degree of underperformance has already materialised, causing concern from Ofgem or the industry.

To avoid this outcome, it is critical that Ofgem establishes a regulatory framework that incentivises good performance but also a close and enduring relationship between Ofgem and NESO, with regular engagements and the provision of constructive feedback leading to the identification and mitigation of any potential risks before any significant performance issues materialise.

The chart below summarises our suggested approach to the monitoring and management of NESO’s performance, with a sliding scale of engagement and escalation, where Ofgem should aim to focus its efforts on the proactive measures outlined in the green box to ensure that NESO’s performance meets or exceeds its expectations, and where the measures in the amber and red boxes are only employed as a last resort.



Similarly to our suggestion in relation to the RGD, we would encourage Ofgem to define in greater detail, within the RIAGD, its proposals for a performance monitoring and management framework based on reputational incentives; and to do so ahead of Day 1, rather than waiting for the next round of updates that

will be introduced from April 2025. This would enable Ofgem to oversee and, where required, intervene effectively to address any potential or actual issues arising during NESO's critical first few months.

FSO Transition Funding Governance Document

In relation to the TFDG, which covers requirements regarding the funding of pre-Day 1 FSO Transition Activities, we are satisfied that the proposed changes reflect the provisions under Condition F10 of the proposed ESO and GSP licences and, therefore, have no further comments regarding this document.

We look forward to continuing our engagement with Ofgem and the wider industry over the coming months to support a successful implementation of NESO.

If you would find it helpful to discuss any aspects of our response in greater detail, please do not hesitate to contact me.

Yours sincerely,

Martin Namor
Senior Regulation Manager