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**25th January 2023**

Dear David,

We are pleased to provide a response to Ofgem's consultation on the policy direction for the Future System Operator's (FSO) regulatory framework. At a high level we are supportive of the policy direction that is outlined in this consultation, but nevertheless we see specific areas where the case for change could be strengthened, and others where there are opportunities to ensure that the regulatory framework maximises benefits for consumers. We summarise our main points below:

- **Evaluating the case for change against the actual performance of the existing regulatory framework:** the development process for the FSO's performance regulation framework must include a lessons learnt exercise of how successfully the ESO's framework has worked in practice.
- **Ensuring agile performance regulation:** as part of the current assessment framework, Ofgem is able to determine whether the ESO's business plans represent value for money. However, in practice the strategic priorities of the ESO frequently change within the two year business planning cycle. As the new framework is developed, it should consider how best to assess costs in an agile way.
- **Achieving effective consumer representation from oversight to delivery:** to ensure balanced views on a broad range of issues, effective consumer representation will be essential. As far as is possible, the engagement framework should seek to be consistent with other initiatives such as the code manager framework.

We would be happy to answer any questions you have about our response.

**Patron HRH The Princess Royal**      **Chief Executive Dame Clare Moriarty**

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Yours sincerely,

Euan Graham

## Questions for consideration

### **The FSO's financial regulatory framework**

1. [Do you have any views on our proposed financial regulatory framework for the FSO?](#)

We agree with the approach laid out in this consultation for the financial regulatory framework of the FSO, and believe it would allow the FSO to achieve its statutory objectives in a way that benefits consumers. We also note that there are other benefits that could be enabled if the proposals were implemented, and the government were able to ensure the FSO was able to manage temporary cash flow issues. Namely, the FSO would be better able to ensure that BSUoS charges were stable and predictable. This would be in the interests of consumers by reducing the risk faced by suppliers when offering fixed-term contracts. To make this effective, clarity is required over how a 'true up' would operate in practice, with sufficient notice required to maintain predictability.

### **Our emerging thinking on FSO performance regulation**

2. [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?](#)

We are generally supportive of a more streamlined and outcome-oriented approach to performance regulation. We also believe that an external evaluation, such as an Ofgem assessment, should be employed to provide stakeholder confidence on the regulatory framework. This is essential to allow remuneration to be linked to performance. When designing this assessment, a key distinction between different types of activity should be recognised. The FSO will progress a number of strategic aims, whilst at the same time ensuring the electricity system is balanced in an optimal way. These activities are separable and we do not believe it is possible, or desirable, to trade off activities across these areas. So, it is likely that different approaches to assessment will be appropriate, with more potential for well-designed metrics to apply to balancing costs.

The new regulatory framework should be designed in a way that learns lessons from how the existing approach has worked *in practice*. As it stands, we are concerned that the case for change has evaluated how the existing approach works *on paper* for the ESO against how it might work for the FSO. This risks including aspects of the framework where the current process is ineffective. In particular, we would highlight the assessment of the ESO's business plan. This provides a useful cost benchmark which is helpful in evaluating whether the ESO has been

broadly efficient. However, the strategic priorities and activities of the ESO often change significantly within the two year business planning cycle. This makes the evaluation of the business plan with regards to the level of ambition of limited use when assessing actual performance.

To overcome this, a lessons learnt exercise focusing on the effectiveness of the current regulatory framework should form part of the development process of any new regulation. When considering how to make the regulatory framework more streamlined and outcome-oriented, Ofgem should also seek to ensure that the framework is agile enough to adapt to changing priorities. We support the continued need for cost assessments on business plans, which can be an effective proxy for ensuring efficient costs, but believe an approach that can more accurately reflect current plans is required to assess ambition. We also believe that considering relevant comparators, including internationally, is helpful for assessing ambition.

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

The FSO will need to deliver at pace as an independent strategic advisory body, whilst also ensuring that its actions are usefully informed by the balanced views of a broad range of industry stakeholders. Key to this will be ensuring effective consumer representation across multiple engagement fora, from oversight (e.g. as part of a steering board) to delivery (e.g. as part of a stakeholder panel). To deliver this, Ofgem should ensure that Citizens Advice and Consumer Scotland have representatives in these fora.

As far as it is possible, Ofgem should seek to ensure consistency between the FSO framework for engagement and other initiatives such as the code manager frameworks<sup>1</sup> and the flexibility market facilitator body.

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

We are not convinced that the phased approach suggested is least risky. The first year of the FSO will be pivotal to the ongoing success of the FSO. Given that the view is that the current regime is not suitable for the FSO, it is clearly a risk to leave much of it in place. As a minimum, elements that could be detrimental to the success of the FSO (for example, by taking up management time that should be focused on developing new functions) should be identified and adjusted.

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<sup>1</sup> [Citizens Advice response to the Ofgem call for input on energy code governance](#), February 2023