

Strategy and Policy Statement for Energy Policy in GB

Energy UK response

August 2023

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, which has over 2,000 members representing over 350 organisations, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity across energy.

Consultation questions:

- 1. Does the strategy and policy statement identify the most important strategic priorities and policy outcomes for government in formulating policy for the energy sector in Great Britain? If not, please provide details of the priorities that you think should be included.**

Whilst we welcome this document and understand the limitations inherent in setting direction while maintaining the independence of these bodies, we feel the document does not go far enough to deliver the fundamental shift required from Ofgem and the FSO in order to deliver on net zero. While the range of priorities set out are broadly correct, there is a need to change the focus of the regulator, and other bodies, from short-term considerations focussed on 'least cost' toward longer-term strategic thinking based on 'greatest benefit'. The SPS could help to provide a strong strategic steer in this regard, alongside the Net Zero Duty expected to be delivered in the Energy Bill.

The document itself is confusing in its drafting, with a lack of clarity on the interactions between various sections, including the Strategic Priorities and Policy Outcomes. There are broad ranging themes that collate a wide range of issues under one heading, and a lack of clarity over how this document changes the role of Ofgem beyond business as usual. It is further unclear how the SPS has been coordinated with ongoing work being led by the Earl of Minto, Minister for Regulatory Reform in the Department for Business and Trade. This includes consideration of a 'Growth Duty' for Ofgem and the ways in which they must better coordinate with other utility regulators. There is a risk that these concurrent workstreams, while well-intentioned, create greater confusion around the role of Ofgem.

Energy UK holds the following views regarding each of the three priority areas set out at the beginning of the document.

- 1. Enabling Clean Energy and Net Zero Infrastructure**

Energy UK strongly supports the clear policy direction to support greater anticipatory investment in energy networks. The industry has long called for the ability for network operators to invest ahead of need to build a resilient network that can connect low carbon generation in a timely fashion. We agree that Accelerating Strategic Transmission Investment (ASTI) is a move in the right direction. However, we would suggest that the SPS is more explicitly clear that ASTI is a first step that aims to address

existing capacity issues with the grid, rather than being truly anticipatory of future need across the network. There must be a subsequent and substantial body of work to deliver short-, medium- and long-term improvements to cost-effective anticipatory network investment.

We welcome the SPS highlighting the need to accelerate grid connections. It should be recognised that whilst there are procedural changes to the connection queue system that can reduce connection timeframes, procedural changes alone will not accelerate connections at the rate required to decarbonise the power sector by 2035 and meet the net zero target. Facilitating this acceleration will require future FSO and Ofgem action plans, and provision for increased resources as needed, including to develop the regulatory framework for competition in onshore networks.

As investors are drawn away from the UK by international policy changes, for example the USA's Inflation Reduction Act, connections delays and an uncertain regulatory environment are exacerbating an increasing risk to UK investment in low carbon technologies. The UK can't out-subsidise the USA, so the best ways to attract investment into the UK are to maintain a stable and predictable regulatory framework, streamline planning and consenting processes and embed the Net Zero focus throughout decision-making.

Energy UK welcomes the confirmation of the role of Ofgem as the regulatory body responsible for heat networks and low carbon heating. It is important that as this work develops, consumers are given clear information and trusted advice. As such there is a need to ensure that appropriate responsibilities and funding are attributed to Citizens Advice to appoint them as the statutory consumer body in this space. Without this, we will continue to see regulation developed without an effective consumer representative body involved, risking negative outcomes for consumers. There is a lack of clarity within the statement on the different needs for domestic & small business versus large industrial heat users. Decarbonisation of industrial heat, such as high pressure steam, is a significant challenge that differs from hot water and space heating and without a clear strategic steer on the two separately, there is risk of counterproductive outcomes, delays to investment and harm to GB's industrial sector.

We are disappointed that, on energy efficiency, the draft SPS has a strategic priority to only provide "opportunities to increase energy efficiency". We consider that the SPS should be much stronger on committing to deliver significant energy efficiencies, at least matching the Government's recent commitments such as the target to reduce buildings and industrial demand 15% by 2030. We also consider that the policy outcome text on low carbon heating ("significantly increased uptake of low carbon heating by 2035") could be strengthened. This text should at least reflect the aims set in the Heat and Buildings Strategy and the Government's target of 600,000 heat pump installations per year by 2028.

Our members are pleased to see that enabling net zero is specified as a principle to inform the design of network charges. However, we note that cost-reflectivity is described as "the key principle" and therefore could be interpreted as being given higher weighting relative to the other principles set out. It is not clear that setting out any such hierarchy is helpful. We would propose that a pragmatic approach is taken to designing network charges that sees cost-reflectively considered within a framework that supports rapid progress on decarbonisation.

A key issue faced across the electricity sector currently is supply chain costs and challenges. How this issue develops and is responded to by the UK Government, devolved administrations, Ofgem and the wider sector will have significant bearing on the pace and cost of decarbonisation. We are pleased to see that the draft SPS notes supply chain challenges as a factor for Ofgem to balance when considering the need for driving competition and that Ofgem should consider market participants ability to procure necessary components in an economically efficient fashion. This will be key to encouraging cost-effective anticipatory investment facilitated by the network price control and charging regimes. We would, however, suggest more explicit recognition in the SPS that regulation that supports investment certainty will include consideration of supply chain challenges, for example through a specific strategic priority.

We agree that barriers to multi-purpose interconnectors and other hybrid or novel assets should be removed and that interconnectors must operate as efficiently as possible. However, we consider that interconnectors simply running efficiently is not sufficient and propose adding 'economically' as a wider catch-all for ensuring costs are minimised for consumers. It is important for Ofgem, the FSO and Government to ensure that interconnectors' role in the electricity system supports and does not risk security of supply. As part of being able to test and ensure these outcomes are met, operational transparency is necessary.

2. Ensuring Energy Security and Protecting Consumers

Energy UK agrees with the Government that issues in the retail market pre-date the gas price crisis, and share the view that resilience, investment certainty, and appropriate regulation are key to delivering a competitive and innovative market that works for customers. We also welcome the proposed policy outcome of restoring consumer confidence in the energy retail market and would highlight that the Government and Ofgem have a key role themselves in reaching this outcome. To this end, there is scope for the Government, the Regulator, and industry to work together on promoting consumer offerings that both meet their needs and facilitate the journey towards a Net Zero energy system.

On the non-domestic market, the Government notes it has become more challenging for businesses to find 'suitable' contracts. Energy UK has previously noted the wide variety of risk profiles suppliers need to take into account when offering contracts, and would further note that the long-term contracts provided during the gas crisis were delivered by the energy sector at the behest of business representative organisations and the regulator in light of the high levels of risk and uncertainty seen in international energy markets.

We note that the strategic priorities and policy outcomes in this section do not include anything on vulnerability, though there is some mention in the subsection paragraphs. We propose that the strategic priorities and/or policy outcomes explicitly reflect the Government's positioning that those domestic consumers in vulnerable circumstances in particular should be protected.

Liquidity in the wholesale market, delayed progress from the ESO on balancing services reform following the Balancing Market Review, and a backlog of rules changes to address inefficiencies in the Capacity Market are all areas of concern for the sector. Continued delays from ESO and DNOs to implement IT upgrades and develop new system services is impacting market participants and creating concern among members about the future operability of the system and the deliverability of the critically important 2035 decarbonised power system target. A sharper focus for Ofgem to monitor and address these problems is welcome.

Safety of the energy system and of the public remains a priority. We propose that this is recognised in the SPS alongside security, resilience, and economic efficiency. The SPS includes resilience by reference to market shocks and international impacts, and we agree that this should be a priority. In addition, we propose that ensuring the energy system is resilient and adaptable to the changing climate, such as more frequent and severe weather events, also be included.

3. Ensuring the Energy System is fit for the Future

Energy UK members seek further clarity regarding the detail of the intended approach to delivering market design that ensures GB has "among the lowest" wholesale energy prices in Europe. Further clarity will aid long-term deployment of low carbon generation, while giving certainty to investors in all generation technologies.

Energy UK welcomes the commitment to a 2024 timeframe for a framework to enable long-duration energy storage.

Energy UK notes that the priority focussed on the delivery of smart meters does not explore the need for Ofgem to constantly review and test policy and regulation driving the rollout to ensure it is delivering the right outcomes for customers. Simply setting and enforcing hard targets, that are not achievable without supporting policies to drive customer acceptance, will lead to cost escalation and multiple and unfruitful customer contacts.

Whilst we welcome the focus in the SPS of digitalisation of the system through the smart meter roll-out, Ofgem must also encourage digitalisation throughout distribution networks, substations, control systems and data gathering. This will give DNOs greater visibility of the status, operation and capacity utilisation of their networks. In turn, this should enable more connections of low-carbon, decentralised assets.

Energy UK welcomes the SPS emphasis on Ofgem's role to work with the ESO to ensure that balancing services are transparently and competitively procured, but would note that these seem aligned with business as usual. In the context of recent high balancing costs, the SPS should include a policy outcome requiring both parties to consider what innovations and reform can be made to address these costs. This should include more efficient price signals for operational dispatch and encouraging innovation and investment in balancing services.

Ofgem recently ruled against NGENSO proposals to introduce Balancing Reserve (BR), on the grounds that the product design was discriminatory. Industry raised concerns regarding the design of BR, which excluded generating assets smaller than 50MW. As we move toward a net-zero power system, flexibility and balancing will enable faster delivery, lower consumer costs, and better strategic deployment of infrastructure (for example network reinforcements).

Energy UK welcomes the recognition of the role that efficient cross-border trading arrangements can have on reducing energy costs, whilst supporting Net Zero 2050. Once again, it is important for the Government to explore resourcing of the regulator, given the recognition of the role of Ofgem in providing regulatory and other necessary support to implement the Trade and Cooperation Agreement (TCA), and in developing the administrative relationships required for EU-UK regulatory cooperation in the energy related matters set out in the TCA – specifically with European Agency for the Cooperation of Energy Regulators (ACER) and other neighbouring National Regulatory Authorities.

Energy UK calls for both the EU and UK officials and regulators to heighten their engagement on the design and implementation of alternative, more efficient electricity trading arrangements in order to lower energy costs (associated with the inefficiencies of explicit trading) and ensure Net Zero is reached in the most cost-effective way; especially since the deadline for the alternative trading arrangements to be in place (April 2022) is now long passed.

Finally, we note that the draft SPS is very light on ensuring system operability and considering innovations and reforms to achieve this. This was surprising in the context of Operability being a leading chapter of the Government's REMA. We therefore propose that the SPS is strengthened in this respect.

2. Does the strategy and policy statement effectively set out the role of Ofgem in supporting government to deliver its priorities? If not, please identify where these expectations could be made clearer.

It is important that each of the strategic priorities is clear in defining which party is responsible for delivery. While SPS' used in other sectors are specific to the regulator, DESNZ has been clear that this document applies more broadly. However, the Energy Act 2013 states that the SPS sets out "the roles and responsibilities of persons (whether the Secretary of State, the Authority or other persons) who are involved in implementing that policy or who have other functions that are affected by it". Without clarity over which party will lead delivery of each priority or how each body (Government, Regulator, FSO) will contribute to delivery, the SPS will not properly empower those parties and

makes it difficult to hold them to account for delivery¹. We would add that it is essential to the successful functioning of the regulatory framework that Ofgem is an effective, independent and authoritative regulator and is generally perceived as being so. To show clear recognition of this, we consider that the SPS should reiterate Ofgem's independence as economic regulator of the energy sector in addition to providing greater clarity on its roles, governance and responsibilities relative to the FSO and Government.

Energy UK notes that across the roles set out in the document there is no mention of how Government expects DESNZ, Ofgem or the FSO to resource this work. Ofgem has seen high turnover in recent years and effectively lost much of its institutional knowledge across the sector. Without an additional focus on recruiting and retaining staff these organisations will be forced to deliver strict prioritisation processes that will see significant delays to workstreams. There must also be a greater focus on building digital capabilities and embedding open data principles at these organisations.

For the FSO, the disruption caused by the transition will inevitably impact employee retention and recruitment. Net Zero requires institutional and cultural reform across energy sector institutions to enable effective delivery in coordination with government. We suggest that the SPS should highlight the priority placed by the Government on setting up the FSO in a way that retains and strengthens the expert capabilities and resources of the ESO. Proper resourcing of this new body will be vital in ensuring that it can carry out its intended role effectively.

Beyond internal process and structures, it is also important that there is a clear and specific expectation of both bodies to deliver a holistic and effective engagement with the industry given the mass of knowledge and expertise available across the sector. This includes engaging with the bodies representing consumers including Citizens Advice and Consumer Scotland. This would aid in ensuring the delivery of effective guidance and regulation that is fit for purpose and delivers the intended outcomes without unintended consequences.

Energy UK holds the following views regarding each of the three priorities set out at the beginning of the document:

1. *Enabling Clean Energy and Net Zero Infrastructure*

It is unclear what role is being given to Ofgem in this space. Given the significant backlog of connections and the long timelines for connection of generation and demand assets, it must be clear whether or not Ofgem is expected to modify RII0-2 frameworks to allow further investment in line with 2030 targets and Net Zero, or if existing mechanisms are deemed to be satisfactory in enabling anticipatory investment. It is also unclear whether Ofgem will be provided further resource in order to enable the proposed expedited process of approvals, with Ofgem already struggling to deliver its wide range of responsibilities. The urgency of climate change and the rapid increase in international competition for investment means we cannot wait for the FSO to be established before resolving the issues seen across GB networks.

We welcome new provisions in the draft Energy Bill to establish a net zero duty for Ofgem. Whilst we appreciate the Bill is yet to receive royal assent, we would expect the final SPS to contain reference to this new duty and address how Ofgem will incorporate the duty into its functions.

Energy UK would further repeat calls for the Government to clarify the intended location of major projects, including CCUS infrastructure, new nuclear plants, and hydrogen production. Without this clarity over the scale, pace, and location of deployment, it is unreasonable to expect the regulator to

¹ In this context, we note that in its [2016 Energy Market Investigation](#), the CMA highlighted that the complementary and overlapping responsibilities of Ofgem and Government has risked creating the perception of a lack of Ofgem independence and, through ineffective co-ordination between them, has caused policy implementation inefficiencies.

deliver meaningful regulatory frameworks for these technologies, or for the FSO to confidently develop plans for the supporting networks.

2. Ensuring Energy Security and Protecting Consumers

It remains unclear how energy markets will be reformed in a timely manner. Alongside delays seen across regulatory reform projects due to reprioritisation in recent years and a lack of resource across the regulator, Energy UK is aware of an increase in concern from the industry about the level of cross-workstream coordination occurring at the regulator. Where areas cross over in terms of regulatory workstreams, it is uncertain if there is a strategic view on the intended outcome or if each team within Ofgem is delivering against its own targeted outcomes without consideration of others, let alone if there is coordination across Ofgem, Government and NGEN on this overarching vision.

The most recent example of this is the range of mentions of roles for the FSO across different engagement sessions, consultations, calls for evidence, and publications in 2023 to date, often deferring action until the FSO is established or attributing new roles and functions to the FSO. The result of this is that the industry is uncertain of the scope and role of the FSO, and unable to interpret if this is a rational deferral of action or rather an excuse applied by various bodies to justify delayed progress.

There is little confidence that the direction entailed in this statement will be sufficient to deliver either a timely or effective reform of the market. REMA, Retail Market reform, and wider reforms and modernisation cannot continue to be progressed in siloes, and a more strategic approach to delivery, in partnership with industry, is required.

3. Ensuring the Energy System is fit for the Future

The draft SPS is unclear on the extent to which Ofgem will be involved in shaping REMA's outcome. This is of concern as Ofgem is progressing thinking on the approach to delivery of Locational Marginal Pricing in the wholesale market, which the majority of Energy UK members oppose due to a lack of clarity on the mitigation of unintended consequences for consumers, a lack of clarity about wider impacts on the market, and the potential risk to investor confidence and continued delivery of critical projects across the UK posed by the transition to new arrangements.

The statement suggests an expanded role will be given to Ofgem in putting in place the arrangements for ongoing regulation of the FSO. More detail is needed here, as both Ofgem and FSO roles could become unwieldy and expensive if not coordinated and funded in an effective and long-term manner.

3. Given the Future System Operator does not exist yet but will need to have regard to the strategy and policy statement once it does, do you consider that we have effectively reflected the Future System Operator's role in this document? If not, please identify where these expectations could be made clearer.

Energy UK welcomes the additional detail provided on the roles and responsibilities of the FSO, and the more broad recognition of the need for a formal and specific SPS for the FSO once it is established. We recognise that the full role of the FSO is not yet defined and would, therefore, welcome a formal commitment to review the SPS once the FSO is formally established.

We note that the Energy Act 2013 sets multiple duties on Ofgem to develop and publish delivery plans and assess progress against the strategic priorities and policy outcomes in the SPS, but no similar obligation is planned for the FSO. Given the Government's proposal to extend the SPS framework to the FSO, for consistency and transparency, the Government might consider also applying such obligations to the FSO.

More detail would be welcome regarding the prioritisation of workstreams as the FSO transitions into its role as FSO / ISOP, particularly in the development of effective balancing markets that reduce the

cost of balancing, establish robust competitive markets for flexibility, and support the continued decarbonisation of power, heat, transport, and the wider UK economy.

We note that the Roles and Responsibilities section of the consultation says that “the FSO should consider the extent to which energy sector participants are providing the kinds of products and services that consumers want”. This text raises questions about what role the Government intends for the FSO to play in the retail market and whether this activity may cross over with existing Ofgem responsibilities. It is unclear to us why the FSO would be better placed than Ofgem to consider this or why it should be a specific responsibility for the FSO in the context of Ofgem’s existing duties. We therefore suggest that this merits reconsideration in terms of its inclusion in the SPS. Alternatively, if this is to stay in the SPS, then we would welcome clarification on what such FSO assessments might cover and how this interacts with Ofgem’s role as the regulator of the retail market.

As noted in response to question 2, clarity would also be welcome regarding the resourcing of the FSO and the delineation of roles and responsibilities between Ofgem and the FSO. With regard to the FSO, there is also further need for clarification of the delineation of roles and responsibilities between FSO, GSO, and network owners. In particular, there is a need for more clarity on how the FSO will interact with regional planning and local delivery of net zero plans. We expect more detail will be forthcoming following numerous Ofgem consultations, which could be integrated into the final version of the SPS.