

IET response to the Call for Evidence to Review Ofgem

Introduction

As Europe's largest professional engineering institution, the Institution of Engineering and Technology (IET) is a trusted adviser to policymakers offering unique expert whole-system thinking. Our strength lies in our ability to convene world-leading experts to provide independent, evidence-led recommendations. From the foundation of the Society of Telegraph Engineers in 1871 to the formation of the IET in 2006, we have grown to be an industry leader spanning 153 countries and comprising 158,000 members from the engineering profession.

This Call for Evidence to review Ofgem's future role comes at a critical moment in the development of the UK's energy sector. The launch of the Government's Clean Power 2030 mission presents a huge challenge for electricity network infrastructure delivery, at the same time as customer bills continue to rise and the debate around who will pay for the energy transition remains unsettled. Solving these material challenges to energy sector stakeholders is of critical importance. Ofgem will play a major role but so will Mission Control, NESO, GB Energy and DESNZ.

The whole system thinking that the IET campaigned for through the Future Power System Architecture project has been widely adopted by NESO and others. We believe this thinking should extend into the regulatory arrangements for the energy sector. Therefore, this review of Ofgem should look across the sector and, as a priority, provide clarity as to how the Clean Power 2030 mission will be governed.

Legal Mandate

Ofgem's legal mandate must not be viewed in isolation without considering how it interacts and works with the mandates of other energy stakeholders. Creating coherence amongst Ofgem, NESO and the Network Operators is essential, prioritising which action is needed, and which body is best placed to deliver it. The Energy Act 2023 extended Ofgem's remit to include heat networks, hydrogen, CCUS, and a statutory net zero duty. This review should ensure that the regulator's legal mandate is harmonious with legislation. It must provide Ofgem with the scope to look across the energy industry to ensure that the regulation of these vectors encourages cross-vector optimisation in investment and operations to support the development of an efficient coordinated and economic whole energy system infrastructure. An example of an area where clarity as to the extent of Ofgem's mandate is required relates to this expansion of new customer offerings such as 'warmth' as a service or 'mobility' as a service. This shifts the focus from selling energy as a commodity, to providing the energyrelated services that customers require. A party offering such a service might be a licensed energy retailer, but equally, they might be a systems provider (e.g. a home-heating system provider, a microgeneration and energy storage system provider, or an EV management system provider). In such cases, the customer offering might include the installation of assets in the customer's home (avoiding the need for the customer to raise capital) in consideration of which the customer makes regular fixed payments over a fixed term in return for a guaranteed service level. The arrangement might extend to the service provider using the 'behind the meter' assets to provide remunerated flexibility services. Unless such services are offered by a licensed energy retailer, Ofgem currently has no powers to ensure that such



customer service offerings are marketed responsibly and/or that they represent fair value for customers; nor does Ofgem have any powers to set performance standards or take action in the event of unsatisfactory service. Given that such services might be particularly attractive in future to vulnerable or low-income families (who might otherwise be unable to afford to purchase the necessary assets and associated home energy management systems) consideration should be given as to whether Ofgem's duty to protect (energy) customers should extend to the licensing of such energy-related service providers. Furthermore, the legal mandate must be aware of interfaces beyond Ofgem's direct remit where they form part of the whole energy system like the Telco sector or data exchange systems. Whilst these things understandably fall beyond Ofgem's formal remit, their obligations should include risk identification, assessment of priorities and timing, identification of solution responsibilities, and mechanisms for making progress across sector boundaries. The legal mandate should clearly outline the scope of Ofgem's role in licencing, consumer protection, and any new onsite consumer services, it must be distinct from the regulator's duties (addressed later) that provide it with the means to act on the mandate.

Ofgem's principal objectives are to protect the interests of consumers concerning gas, electricity and heating systems.¹. While protecting the economic interests of consumers should remain the key priority for the regulator (considering the significant changes required in the UK's energy system) this must be broadened to cover the whole energy system. There is an existing precedent for this in government, for example, the Food Standards Agency's legal mandate² is more aware of the whole system across the food industry, widely protecting consumers. Increasing the breadth of Ofgem's legal mandate objectives to have greater awareness for the whole system will help ensure that the regulator has a detailed landscape view of the market.

Clarification of Ofgem's role within the energy system is necessary to ensure it works in a coordinated manner with the obligations possessed by other actors, including Great British Energy, the National Energy System Operator (NESO), and Mission Control. Expanding Ofgem's mandate to deliver whole system thinking would better empower it to ensure that customers are not mis-sold or treated unfairly driving up consumer confidence after several turbulent years. However, this can only be achieved if the working relationships with the aforementioned bodies are clearly outlined with distinct areas of responsibility. The concern is that responsibilities are granulated and siloed across the various bodies, leading to disjointed and inharmonious delivery. A whole system-mandated Ofgem, as the regulator with customer wellbeing at the centre of its mandate, could mitigate this as Ofgem can only regulate where it can issue licenses. Whole system awareness could illuminate where it may be appropriate to expand Ofgem's licensing responsibilities.

Duties

https://www.legislation.gov.uk/ukpga/2023/52

² <u>Who we are | Food Standards Agency</u> "to protect public health from risks arising from the consumption of food and generally to protect the interests of consumers in relation to food".



There must be clarity between the duties of Ofgem, the Independent System Operator, and Network Owners.

Embedding a whole systems approach in Ofgem's mandate will provide a strong foundation for clarity over how Ofgem manages its duties in the context of the associated hierarchy of government energy system stakeholders. It is important that Ofgem recognises NESO's role as an Independent System Operator (ISO) that plans across all energy vectors, understanding what NESO is and is not accountable for. To support this, Ofgem could adopt a regulatory approach that is aware of time constraints and targets as well as costs. This must allow the ISO the space to advise on the system architecture that we need to build and act as an integrated system planner that provides independent advice to the Government, and Network Owners to deliver that infrastructural deployment. Ofgem's role is to ensure value for money for customers, and economic efficiency in deployment. We want to see it take a joined-up approach to regulation to achieve this, duplication and overlap with other bodies must be avoided. Its duties should focus on challenging processes and costs, publishing benchmarks, driving competition in delivery and setting commercial incentives. Roles requiring specific technical expertise, such as system integration which will be essential for the Clean Power 2030 mission, should remain outside of Ofgem's remit to ensure it remains aligned with its core function as an economic regulator.

The Government's Clean Power 2030 action plan sets out extensive sector changes which will continue beyond 2030. The plans highlight multiple activities, the engagement of multiple players, and the need for whole-system joined-up thinking. The Government's Mission Control must come forward with the details on who will be the system integrator. System integration is a recognised element in complex engineering activities and its absence can result in deeply problematic project outcomes. For example, the Cross Rail project faced significant delays and cost overruns due to the complex integration of multiple signalling systems, which resulted in communication faults and software bugs³. The Government must be careful that Ofgem does not become the system integrator by default.

Transparency and Accountability

Greater digitalisation and streamlined reporting and publications are needed to drive transparency and accountability.

Ofgem's annual reports offer valuable insight into network performance and customer satisfaction. However, key stakeholders – such as business users – who are deeply impacted by Ofgem's work, may find navigating this technical content time-consuming. Digitalisation presents an opportunity to enhance these reports by providing greater granularity, transparency, and accessibility for stakeholders. To maximise the potential of digitalisation,

³ <u>Challenges of Integrating Electrical Systems in a Mega Project - Examples from Crossrail - Crossrail Learning Legacy</u>, <u>Crossrail delay: signalling issue create setback for London project (railway-technology.com)</u>



Ofgem should streamline its processes to reduce the time it takes to publish reports and ensure that metrics are published in an accessible and timely manner. Leveraging Al-driven tools such as automated summarisation or interactive dashboards, could help tailor insights to different audiences, making it easier for businesses and consumers to engage with critical information. A more proactive approach to digitalisation would both improve stakeholder engagement and reinforce confidence in Ofgem as a transparent regulator.

Skills and Capability

To be more effective Ofgem needs to become a more flexible and agile regulator. Periodic price reviews alone cannot effectively identify the needs for medium to long-term investment. A form of price control (not limited to uncertainty mechanisms) is needed that is based on long-term planning but is flexible to respond to changing investment drivers.

Ofgem's role in the Clean Power 2030 Mission increases the need for enhanced engineering capability. Ofgem needs sufficient technical skills and experience to regulate all aspects of the system whilst not being transformed into a technical decision-maker. Care is needed to ensure that engineering decisions remain with the respective asset owners and NESO, avoiding dictation to asset owners on decision-making. Development of skills around the use of incentives in asset industries and the development of infrastructure is needed to ensure licensed parties can make effective decisions. To deliver these duties effectively, Ofgem needs to ensure that it has the appropriate number of economists and engineers, including those with skills in whole systems thinking, so that it can understand, anticipate and address emerging regulatory issues with the technical knowledge base required. To achieve this Ofgem must be able to compete effectively in the employment market for high-level engineers.

Ofgem's Regulatory Remit.

Ofgem's regulatory remit should acknowledge and include climate adaptation and the costs that might be incurred in the longer term.

Ofgem's remit should seek to find the appropriate balance between today's customers and future customers to deliver longer-term interests in managing net zero and climate adaptation. The challenges in connecting new low-carbon demand and renewable generation require that a longer-term perspective is driven by Ofgem.

Whilst Ofgem's extended remit under the Energy Act is welcome, this must be reflected by removing regulatory barriers that are preventing effective interaction between energy sectors. As discussed in question two, Ofgem should minimise friction and overlap in their relationship with NESO by recognising NESO's role as an ISO that plans across all energy vectors and understanding what NESO is and is not accountable for. It should be noted that Ofgem is just one part of the governance framework of the energy sector. A whole systems view of this framework should be taken to consider what regulation is required and which body should be responsible emphasising the need for the remit and roles of NESO, DESNZ and Ofgem to be clarified.

Delivering Investment and Innovation in the Transition



It should be a priority for Ofgem to deliver resilience in the long term by prioritising forward thinking and driving innovation. To support net zero targets, Ofgem should assume a role in anticipating investment needs up to 2050 coupled with a flexible regulatory regime to allow quick progress for the right products. The government should explore whether Ofgem should have a wider role than currently embodied through SIF in promoting innovation and reducing barriers to it, recovering costs. Energy system regulation legislation was drafted with the intention of regulating monopolies and the big 6 companies, this could be reviewed in 2025 and inhibitors to small-scale local energy systems removed. The existing business plan approach can be slow and presents Ofgem with the opportunity to be proactive by sharing successful innovations with other operators.

Whilst Ofgem has a duty to protect customers through competition, this must be balanced with the need for strategic coordination and an agile timely delivery framework. For example, the Accelerated Strategic Transmission Investment (ASTI) framework sets aside the need for competitive tendering for building transmission infrastructure to meet challenging timescales presented by the drive to decarbonise electricity production and in particular Clean Power 2030.

The ED3 consultation on distribution network company price controls introduces welcome new thinking from Ofgem which should be encouraged in support of growth and meeting Net Zero targets.⁴. Paragraph 6.1 discusses networks "being ready" for the challenges of demand growth and new technologies. This contrasts with Ofgem's previous positioning which did not allow "investment ahead of proven need". There remains a need in customers' interests to encourage efficient capital investment, but new thinking in this area could be valuable.

Low Carbon Technologies

It should not be part of Ofgem's remit to 'enforce' the adoption of low-carbon technologies, rather it is for Government to put in place the necessary support mechanisms to encourage customer take-up. However, as mentioned, there may be scope for Ofgem to report on where the barriers to the uptake of emerging technologies are and what actions are needed within and beyond its remit.

Ofgem's role should be to ensure that energy retailers and DNOs provide the means to accommodate low-carbon technologies through compatible supply offerings (e.g. time-of-use and dynamic tariffs) and sufficient network infrastructure. In particular, vulnerable and less affluent customers must be accommodated so as not to be prevented from benefitting from new opportunities such as EV charge points. As the energy system becomes more complex and interactive, Ofgem needs to maintain consideration for customers throughout.

Quicker response to emerging issues

A lack of foresight and anticipation of emerging challenges could lead to poorer decisionmaking. To respond effectively to challenges, Ofgem must be forward-thinking in its risk assessments and proactive in delivering regulation, rather than relying primarily on

⁴ <u>ED3_Framework_Consultation.pdf (ofgem.gov.uk)</u> Section 6.1, pg. 35.



competitive forces. This could be addressed by introducing a foresight process and employing the skills and expertise needed to anticipate systemic, economic, market, social and technical issues. Ofgem should assume a contingency management approach when responding to emerging issues. It should start by creating transparency around emerging issues by publishing a register of risks it is considering e.g. market failure, insufficient investment and skills. Ofgem should own risks that sit within its economic remit. Forward-looking risk assessments are core to building responsiveness to emerging issues.