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## ESO Response to Smarter Regulation: Strengthening the economic regulation of the energy, water and telecoms sectors

Dear Minister Hollinrake,

Thank you for the opportunity to respond to your consultation on smarter regulation: strengthening the economic regulation of the energy, water and telecoms sectors.

### Who we are

As the Electricity System Operator (ESO) for Great Britain, we are at the heart of the energy system, balancing electricity supply and demand second by second.

Our mission, as the UK moves towards its 2050 net zero target, is to drive the transformation to a fully decarbonised electricity system by 2035, one which is reliable, affordable, and fair for all. We play a central role in driving Great Britain's path to net zero and use our unique perspective and independent position to facilitate network and market-based solutions to the challenges posed by the trilemma.

Our transformation to a Future System Operator (FSO) is set to build on the ESO's position at the heart of the energy industry, acting as an enabler for greater industry collaboration and alignment. This will unlock value for current and future consumers through more effective strategic planning, management, and coordination across the whole energy system.

### Our key points

Having a central role in the energy industry, our key regulatory relationship is with Ofgem. This relationship is evolving as the ESO becomes the FSO, which will be an expert, impartial body, with an important duty to facilitate net zero whilst also maintaining a resilient, and affordable system. This provides a unique opportunity to review the regulatory framework it operates under, to ensure it sets the FSO up for success to drive net zero and value for consumers, and which is currently being consulted on by Ofgem separately.

We recognise that the pace of change which regulators, including Ofgem, face, is unprecedented, and will require updates to the regulatory frameworks to ensure delivery of the necessary solutions to tackle climate change, energy security needs and cost of energy issues. There is a need to ensure that the energy sector more broadly is driving the right behaviours to achieve the best outcomes for consumers.

We recognise the key role the FSO will play in feeding into an infrastructure wide needs assessment through the Strategic Spatial Energy Plan (SSEP) and Centralised Strategic Network Plan (CSNP) and in developing the competition-led models to drive strategic investment in networks.

We look forward to engaging with you further. We have responded in more detail to a selection of the consultation questions below, and we have no comment to make on the questions not included.

Should you require further information on any of the points raised in our response please contact Laura Thomson, Regulatory Policy Manager, at [laura.thomson@nationalgrideso.com](mailto:laura.thomson@nationalgrideso.com).

Yours sincerely

Adelle Wainwright

Regulation and RIIO Senior Manager

## Appendix 1 ESO Response to Consultation Questions

## Driving economic growth and investment

**Q1.** The government welcomes views on appropriate terms of reference, including scope, for such an infrastructure needs assessment, as well as views on who would be best placed to deliver this. The government welcomes any further views on the assessment.

The FSO will play a central role in the strategic planning of the energy system of the future. Through the Strategic Spatial Energy Plan (SSEP) we expect to set the direction for the location for future energy supply and demand. Through our Centralised Strategic Network Planning (CSNP) activities we expect to set direction on the future needs of the UK energy network infrastructure. Although the status of the SSEP and the CSNP is to be finalised, we expect them to establish the initial future needs case for projects they consider. We will also be developing Regional Energy Strategic Plans to unlock benefits for local communities and across the country more broadly, by more effectively aligning regional and national energy network plans.

We note the need for a holistic approach to wider infrastructure investment across the wider utilities sectors, to include environmental, marine and land usage, and water infrastructure development, particularly in relation to hydrogen. We expect that existing bodies such as the Geospatial Commission<sup>1</sup> or the National Infrastructure Commission<sup>2</sup> would have a role to play in the development and provision of such a broader utilities' infrastructure needs assessment.

## Competition

**Q20.** Do further opportunities exist to introduce greater competition for strategic investment into the water and energy sectors?

Currently, we are working on the implementation of an early competition model to launch in 2024 (as set out in the Transmission Acceleration Action Plan). An early-stage competition approach requires the holistic, long-term view and strategic planning of infrastructure as envisaged through the SSEP, the CSNP and RESPs. We believe that being able to draw from a suite of competition types presents a suitable approach. For example, early-model competition will sit alongside Network Services Procurement (NSP) and the Offshore Transmission Owner (OFTO) regime. Some projects may also be more suitable for competition through a late-stage model, which occurs after the main design phase is completed and major planning consents have been obtained.

In future, an offshore hybrid asset (OHA) could enable offshore wind and interconnection to work together as a combined asset and have the potential to unlock large volumes of offshore wind zero carbon energy sources, facilitating offshore wind connections and driving consumer value.

**Q21.** What alternative funding/competition delivery models could be considered?

As outlined in our response to Question 20, we are developing an early competition model, allowing organisations to compete for the design, build and ownership of onshore transmission solutions.

The Winner report set out that early clarity is needed on which projects would be subject to competitions and the Government's response, as set out in the Transmission Acceleration Action Plan, agreed that quick decisions on whether new projects are suitable for competition or not during the planning process will lay the foundation for effective competition in networks, to improve efficiency and promote innovative practices.

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<sup>1</sup> <https://www.gov.uk/government/organisations/geospatial-commission>

<sup>2</sup> [National Infrastructure Commission \(nic.org.uk\)](https://www.nic.org.uk)

## Duties and Functions

### Q28. What would be a suitable timeframe in which to conduct a review of these regulators' duties?

There is a huge amount of change in the energy sector at the moment, including with our own organisation going through a transformative process. It is vital that the regulator has the right set of duties in place to ensure that regulation is appropriate in this ever-evolving environment, therefore a review at this time may be appropriate. However, this has to be balanced with a need to provide stability for the sector.

It may be helpful to review all regulators duties at the same time to ensure they are working in a coherent manner, for example to ensure that inputs to the infrastructure needs assessment outlined earlier are consistent and holistic across telecoms, energy, and water sectors.

### Q29. What is an effective remit for economic regulators? How can regulators improve delivery of both economic and non-economic functions?

Economic regulators exist to protect the interests of end users by ensuring the operation of well-functioning markets and delivering a system of penalties and incentives to replicate the positive outcomes of a competitive market. Where a regulator has a number of overlapping duties, these may at times complement and at other times compete against each other. It is the skill of the regulator to balance those decisions and to do so in a way that is transparent and open to scrutiny.

In terms of improving delivery, digitisation offers the opportunity to enable improvements in data-sharing and automation of regulatory reporting. Innovations in this space may address issues such as information asymmetry or enable more agile price control setting. Improved access to datasets may shorten the timeframes between performance and reward or penalty.

Automation of process-driven, non-economic functions may allow for a refocussing of resource onto more complex economic considerations.

### Q30. The government's provisional view is that regulators' economic core duties are: Fostering economic growth; Ensuring effective competition; Delivering Net Zero and protecting the environment; Protecting consumers. Are these the correct set of core economic duties regulators should be focused on? If not, what should regulator duties be focused on?

We agree that regulators' economic core duties are as described, and these are all required to balance current and future societal needs. Effective competition is an enabler for delivering economic growth and ensuring that consumers have a choice to incentivise best practice. For effective competition to persist, regulators must ensure the resilience of organisations across all points of the supply chain involved in the delivery of utilities to the end consumer.

### Q31. What are key benefits of this approach? What might any risks or unintended consequences be?

The key benefits of this approach are that there is a diversity of stakeholder need to be considered in decision-making so that no single duty is preferred to the detriment of others. The risk is in the difficulty of applying that balanced and multi-faceted view, and ensuring that robust processes are in place considering all the different needs for decisions which are being delivered at pace.

**Q32.** The government welcomes your views on enabling the CMA to have the additional flexibility to appoint larger groups to hear non-price control water appeals and energy appeals. What might be the downsides of this approach? Do you have any evidence of alternative models e.g., international comparators?

Giving the CMA the flexibility to appoint larger groups ensures that key experts can be called upon to participate in an appeals panel. This may give appellants increased confidence that a more robust decision has been arrived at. However, it may increase the time taken to appoint and consider cases which becomes more costly. For appellants whose appeal is unsuccessful there is also the risk of increased costs.

**Q33.** What are the risks to consider before giving CMA power to directly extend deadlines in energy and water appeals? What opportunities do you feel this proposal may create? Do you have any evidence regarding this proposal that the government should consider?

Whilst there is potential benefit in having additional time to call on expert testimony and opinion, review arguments and have additional time to scrutinise all evidence before coming to a decision, there is a risk that extending deadlines adds further costs and complexities to the process.

**Q36.** What unintended consequences or risks should the government be aware of when considering making this amendment to code modification appeals?

The Energy Act 2023 has introduced the role of licenced Code Managers, and we would like to have more clarity on whether the proposed change would impact this new type of entity in carrying out their role of taking decisions on changes put forward by other parties as well as raising changes of their own to achieve the strategic direction set by the regulator.