drax

Drax Group plc
3rd Floor, Alder Castle
10 Noble Street
London
EC2V 7JX
www.drax.com

4th September 2020

Network Price Controls
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU
RIIO2@ofgem.gov.uk

Non-confidential

Dear Sir/Madam,

Electricity System Operator (ESO) RIIO-2 Draft Determination

Drax Group plc (Drax) owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets – providing enough power for the equivalent of more than 8.3 million homes across the UK. The assets include Drax Power Station, based at Selby, North Yorkshire, which is the country's single largest source of renewable electricity. Drax also owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 390,000 business premises.

We make the following key points on the ESO's RIIO-2 Draft Determination:

- We believe that the regulatory framework should create strong incentives for the ESO to take a long-term approach in managing the system and proactively engage with the market to unlock long-term consumer benefits, rather than relying solely on short-term actions which may not always be in the best interests of end consumers.
- We support Ofgem's efforts to keep the ESO regulatory and incentives process as simple and efficient as possible. We believe there is scope for the reporting and performance evaluation processes of the scheme to be simplified and streamlined further.
- The financial reward should be determined each year rather than at the end of the 2-year scheme. This will ensure a strong ongoing link between ESO performance and the financial incentives available.
- We believe the current incentive value is too small to incentivise the ESO to go over and above baseline expectations. Considering that the ESO will need to play a central role in the transition to Net Zero, and the expectation that it could deliver up to £2bn consumer benefits over the RIIO-2 period, we consider that a greater financial incentive could drive better performance, while still representing value for money.
- We are unclear why it's proposed that performance metrics will not be considered when assessing ESO performance in relation to Role 3 (system insight, planning and network development). We

would see merit in using specific metrics for Role 3, as it would make the link between performance and incentives clearer and stronger.
- We're concerned that only giving two years of certainty for Network Innovation Allowance (NIA) funding will deter the ESO from developing a more meaningful, long-term innovation strategy that could benefit consumers and accelerate the energy system transition.

Our detailed response to specific consultation questions, particularly focussed on the incentives framework and innovation funding, is appended. We would be happy to discuss any aspect of our response with you further if it would be helpful.

Yours faithfully,

Submitted via email

Marcelo Torres

Regulation Manager, Markets
Drax Group plc.

drax

Appendix - Detailed response

ESOQ1. Do you agree with our proposal to incorporate EMR into the ESO's wider outputs incentives scheme?

We agree with Ofgem that incorporating the EMR Delivery Body within the ESO's wider framework should allow the ESO to take further advantage of the synergies, thereby enhancing delivery against the objectives for EMR.

ESOQ2. Do you agree that it is appropriate to maintain the ring-fence between the EMR DB and the ESO in its current form?

No, we do not believe it is still appropriate or beneficial to maintain the ringfence between the EMR Delivery Body and the wider ESO. The ringfence was introduced in 2013 to address concerns around conflicts of interest with the National Grid Transmission Owner business. The ESO is now a legally separate entity and so the original concerns regarding conflicts of interest should be sufficiently mitigated. If the ringfence remains in place, the EMR delivery body would not be able to fully realise service improvements by utilising ESO data and analysis.

ESOQ3. Do you agree we should regulate system restoration costs in a consistent manner to other external balancing costs?

The current regulatory framework for Black Start, which involves ex-post cost justification, increases the regulatory risk for the ESO. This typically leads to more risk-averse decision-making by the ESO, which in turn can lead to inefficient contracting and sub-optimal results for system security and costs to consumers. We support the proposed departure from the current incentives regime for Black Start costs and its bespoke cost disallowance mechanism. We agree that the ESO's performance in relation to system restoration should be considered as part of the wider incentives scheme, in a manner consistent to other external balancing costs. The ESO should be encouraged to take a more forward-looking, strategic approach to addressing system restoration needs, with focus on efficient procurement rather than on short-term cost savings. We would welcome additional clarity on how Black Start costs would be considered as part of the wider balancing costs metric.

The continued requirement for the ESO to produce a robust Black Start strategy and methodology is welcomed. We would encourage the ESO and Ofgem, as part of the final submission and the approval process respectively, to be transparent in the way they address the points raised by stakeholders through the ESO's consultation.

ESOQ4. Do you agree with our approach to setting up-front performance expectations?

We support Ofgem's intention to set up-front performance expectations in RIIO-2. Currently there is some ambiguity around what specific behaviours and outputs constitute above, below and in-line with baseline performance. In previous years, there have also been concerns regarding the level of ambition in the ESO's Forward Plan. While we consider the ESO's business plan for RIIO-2 sufficiently ambitious, a more up-front approach to setting expectations would provide greater clarity to the ESO as to what constitutes an appropriate level of ambition and stretch for future business plans.

Additionally, as we have seen many ESO deliverables delayed over the past few years, we would reiterate the importance of delivering reforms and projects in a timely fashion. While we appreciate some delays are caused by unforeseeable circumstances or factors which are outside the ESO's control, we welcome up-front expectations on when certain key milestones should be achieved.

ESOQ5. Do you agree that a financial reward or penalty should be determined every two years, to align with the period over which we set expectations, costs and outputs?

We believe that an assessment on ESO performance should be made every 12 months with the corresponding incentive value paid at that point. Determining the financial reward / penalty every two years would result in a weaker and less predictable relationship between the ESO's performance and its reward. We also note that employee bonuses (based on either individual or company performance) are usually paid on an annual basis. It would make sense to align the incentive payment with this widely adopted practice.

Also, if a decision is not made every 12 months, there is a risk that performance across the whole incentive period is not properly taken into account. Outputs or events which occur towards the end of the scheme may be given undue weight, and achievements at the start of the scheme may go unrewarded.

Moreover, under the current annual scheme, the ESO has struggled to correctly forecast the incentive amount which they recover through BSUoS charges in the year. Moving to a two-year scheme will only increase this uncertainty, resulting in more volatile BSUoS costs.

For the above reasons, we believe that Ofgem and the Performance Panel should make a decision on the incentive reward at the end of each year.

ESOQ6. Do you agree with our proposed approach to within-scheme feedback, including the timings and approach to performance panel sessions?

Note our response to ESOQ5, where we express a preference for the financial reward / penalty to be determined at the end of each year.

We support Ofgem's proposal for the Performance Panel to provide the ESO with feedback at six-monthly intervals. We have found that the six-monthly intervals give industry adequate opportunity to comment on the ESO's performance. We note that the Call for Evidence on the ESO's performance is a resource-intensive exercise for stakeholders. We would prefer a 'lighter' mid-period evaluation process that involves stakeholder feedback collected through a dedicated public event followed by a survey, rather than through a comprehensive Call for Evidence on the ESO's performance. This 'lighter' mid-period evaluation process would take place on a six-monthly basis. Detailed stakeholder feedback would then be collected through a Call for Evidence annually (at the end of the year).

The volume of reporting that goes into each review appears complex and burdensome on the ESO and the Performance Panel. We would like to underline the need for this process to be as simple and streamlined as possible to ensure strong stakeholder engagement.

ESOQ7. Do you agree with our proposed evaluation criteria for RIIO-2?

Yes, we are broadly supportive of the proposed evaluation criteria. To maintain strong incentives on the ESO, it is important that the top scores are realistic and are accessible to the ESO where its performance exceeds baseline expectations. Similarly, low scores should be given where the ESO fails to perform well against most of the evaluation criteria.

We welcome the inclusion of an explicit evaluation criteria on stakeholder feedback. Market participants are well placed to comment on the ESO's performance and this will ensure that positive / negative feedback is directly considered as part of the evaluation process.

It is proposed that for Role 3 (system insight, planning and network development) the performance metric evaluation criterion is removed *"to reflect the difficulty in setting robust performance metrics for this role, given its longer-term focus"*. We're unclear why this is necessary or appropriate. Despite its long-term focus, performance metrics could be set in relation to Role 3 and we would be happy to engage with the ESO and Ofgem to discuss possible options.

ESOQ8. Do you agree with our proposals on the incentive scheme value?

We support the proposed asymmetry but believe that the maximum reward could be higher to create a stronger incentive on the ESO to perform above the baseline expectations. The asymmetry will incentivise the ESO to take more (calculated) risks where they believe there could be substantial benefits, without the fear of large financial penalties should the expected benefits not materialise.

The ESO estimates they can deliver benefits of £2bn over the course of RIIO-2. Given these substantial benefits, and the ESO's crucial role in the energy system, we believe the maximum financial reward could be greater than £30m every two years. We note that this amount is currently available to the ESO as the maximum financial reward every year. This would give a stronger incentive on the ESO to improve their performance. As the ESO could deliver benefits that far outweigh this amount, a greater incentive value would still represent value for money for end consumers and BSUoS payers.

ESOQ30. Do you agree with the level of proposed NIA funding for ESO? If not please outline why.

ESO innovation projects have the potential to reduce whole system costs in the long-term and enable a secure transition to Net Zero.

The draft determination proposes to give the ESO the amount they have requested for 2021/22 and 2022/23 but does not make a decision at this time for the following 3 years of the RIIO-2 price control. We support Ofgem's decision to allow the ESO the full amount they have requested for the first 2 years but believe that having only two years of certainty for NIA funding will deter the ESO from developing a more meaningful, long-term innovation strategy that could benefit consumers and accelerate the energy system transition.

More generally, we would like the process behind selecting which projects get taken forward to be more transparent and consider partnerships with a wider range of actors from across the industry. Currently, there seems to be little opportunity for market participants (e.g. generators) to get involved, with most of the projects seeking network solutions rather than market-based ones. We would welcome greater engagement with the ESO to understand how NIA funding is allocated.