



Making a positive difference
for energy consumers

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Date: 30 July 2021

Dear Stakeholders,

Decision and Direction on the Electricity System Operator's financial incentive for 2020-21

The Electricity System Operator (ESO) published a report on 7 May 2021 containing final evidence of its performance over the regulatory year (the 'End of Year Report')¹ under paragraph 16 of Special Condition (SpC) 4M of NGENSO's² Electricity Transmission Licence (the 'Licence')³ that was in effect on 31 March 2021 for the 2020-21 incentive period.

In June, the ESO Performance Panel (the 'Panel') convened to assess the ESO's performance for the 2020-21 regulatory period. Following this, we⁴ have reviewed the End of Year Report and have considered the Panel's recommendation⁵ and other monitoring and stakeholder evidence to decide on a financial incentive value. This letter sets out our decision and direction to award the ESO a financial incentive of £5 million for its performance in 2020-21.

Background

¹ The ESO's end of year report 2020-21: <https://www.nationalgrideso.com/document/191446/download>

² National Grid Electricity System Operator Limited (NGESO) is the registered company name of the ESO.

³ The 2020-21 incentive period runs from 1 April 2020 to 31 March 2021. Therefore, we refer to the licence in effect on 31 March 2021, which applies to this incentive period. This version of the licence can be found on the Electronic Public Register (ePR): <https://epr.ofgem.gov.uk/Document>

⁴ The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refers to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

⁵ The ESO Performance Panel's end of year recommendation for 2020-21: <https://www.ofgem.gov.uk/publications/eso-performance-panel-end-year-review-2020-21>

Our evaluative incentives framework consists of a set of 'Roles and Principles'⁶ designed to provide clear expectations about the baseline behaviours we expect from the ESO. The ESO is required to produce a Forward Plan, following stakeholder engagement. The plan should describe the activities the ESO will undertake over the year to fulfil its roles and where it expects to add additional value for consumers.

The Panel's remit is to scrutinise the ESO's plans and delivery and make a recommendation to us on the ESO's performance. We use this recommendation, as well as other monitoring and stakeholder evidence, to decide whether to financially reward or penalise the ESO up to a maximum cap and floor of \pm £30m. In Annex 2, we have set out the key steps involved in assessing the ESO's performance over the year, how the evaluation process works and how this feeds into our determination of the ESO's financial reward/penalty.

We expect a high level of service from the ESO. Based on its commitments under the existing RIIO-T1 price control and the obligations contained within the Licence, the ESO should be economic, efficient, and demonstrate the behaviours and standards described in our Roles and Principles Guidance in order to meet our baseline expectations.⁷ Incentive payments will only be rewarded for going above and beyond baseline expectations, where the ESO demonstrates actions which deliver additional consumer benefit.

Our decision

The incentive year ran from 1 April 2020 to 31 March 2021. We have reviewed the ESO's performance over this period using the methodology and evaluation criteria described in Annex 2. **Overall, we consider that the ESO has gone some way to exceeding our baseline expectations of a competent and effective ESO (with some variation across the roles), particularly in the context of a very challenging year.** We direct that the ESO will receive a financial incentive of **£5 million for 2020-21.**

Summary

We have provided our detailed assessment of the ESO's performance against each role (with a score available for each role of 1 to 5) in Annex 1. A summary of our decision is below. In all instances, the scores should be read alongside the detailed feedback and the reasoning provided:

⁶ ESO Roles and Principles Guidance for 2020-21:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/eso_roles_and_principles_guidance_2020-21.pdf

⁷ We use the phrases 'met our baseline expectations' and 'in line with baseline expectations' interchangeably in this document and refers to our baseline expectations as set out in Box 2 of the ESORI guidance 2020-21:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/esori_guidance_document_2020-2021_final.pdf

Table 1. Summary of incentives decision 2020-21

Role	Role 1	Role 2	Role 3
Ofgem Score	4	3	3
Incentive reward / penalty	+£4m	£0m	+£1m

- Since the introduction of this incentive scheme in 2018, the ESO's overall performance has improved each year. Within this year the ESO has responded to feedback and as a result its performance has improved since the mid-year stage. This is reflected in higher end of year scores and provides a strong foundation to build upon into the RIIO-2 price control framework.
- We recognise that COVID-19 has brought forward some unexpected challenges this year. We commend the ESO on its response to the pandemic and on maintaining the security of the system, despite the challenging and unprecedented system conditions created by COVID-19. The ESO's response to COVID-19 has fed into our assessment for each role (particularly Role 1 and Role 2).⁸
- On Role 1, we have awarded a score of 4, which equates to exceeding our expectations. Our conclusion was mainly driven by the ESO's response to the pandemic in ensuring system security. The quality of the ESO's engagement with its stakeholders, particularly the introduction of the Operational Transparency Forums, was also a strong positive factor. The main negative element was high balancing costs that continued even after demand levels returned to close to normal levels. Stakeholder feedback was also generally more positive this year and the ESO had strong performance with its demand forecasting, keeping the accuracy in line with previous years despite the challenges of COVID-19. The remaining evidence provided for Role 1 met baseline expectations such as wind forecasting and the ESO's evidence of benefits. Overall, we considered that the positives outweighed the negatives and we factored in the Panel's overall recommendation of a score of 4. Within this, we have placed slightly more weight on the ESO's pandemic response and relatively less weight on the balancing cost metric. We have therefore decided on an incentive value of £4m.
- On Role 2, we agreed with the Panel and considered that the ESO met our baseline expectations. Since the introduction of this scheme, the Panel, stakeholders and Ofgem have highlighted the importance of delivering tangible new markets and product developments. At the mid-year stage, the Panel gave the ESO a score of 2 (noting the ESO was in the higher range of this score), due to some areas of

⁸ On 24 April 2020, we issued an open letter to the ESO. In that letter, we set out a process for the ESO to demonstrate necessary delays in 'lower priority' ESO activities to enable the ESO's response to the COVID-19 pandemic. This framework of regulatory flexibility was put in place for an initial period and ended on 30 June 2020. The ESO had several deliverables (mainly under Role 1 and Role 2) which were delayed as a result. We discuss this further in Annex 1. Our letter can be found here: https://www.ofgem.gov.uk/system/files/docs/2020/05/ofgem_response_to_eso_COVID-19_impact_letter_may_2020_0.pdf

underperformance, such as ongoing delays to balancing market reform. Since then, the ESO has acted upon the mid-year feedback and its performance has become stronger in the second half of the year. The ESO's adoption of a co-creation approach toward delivering market reform and its improved code administrator stakeholder satisfaction scores, given the context of the pandemic, were positive improvements. We also noted the ESO's Markets Roadmap which provided more clarity to industry on upcoming market reform. The ESO's plan delivery largely reflected a set of business-as-usual deliverables. The on-the-ground implementation of new balancing services was a positive step and showed agility in the face of difficult circumstances. However, the necessary reforms to the ESO's balancing products have been a long-standing industry priority and the various implementation issues experienced this year, alongside mixed stakeholder feedback, meant we considered this work as meeting our expectations. The areas for improvement were the ESO's cross border balancing arrangements and the significant BSUoS billing error, which did not meet our expectations. Looking back across the full 12 months, we consider that the positives rebalance the negatives to bring the ESO up to meeting expectations and so we have awarded the ESO a score of 3 and an incentive value of £0m.

- On Role 3, we considered that the ESO had largely met our baseline expectations with some elements of outperformance. We considered the ESO's plan delivery to be marginally exceeding expectations, given the context of the pandemic and the challenging nature of some of the deliverables (in particular the stability and voltage pathfinders). Loss of mains, the ESO's engagement with ENA open networks and the early competition workstream have all been positive and have met our expectations. However, we consider that the ESO could have made more progress toward constraint management as this is a key area that will maximise consumer value. We decided on a score of 3 and considered the ESO to be toward the higher end of this score as we factored in the Panel's recommendation and the context of delivering during a pandemic. Therefore, we have decided to reward the ESO with £1m.
- Going forward, the ESO will be assessed as part of our RIIO-2 price control framework (see more details below). We have set out our expectations of the ESO in the ESO Roles Guidance for each role.⁹

Direction and Notice

Attached to this letter in Annex 3 is a formal Direction on the financial incentive for the ESO regulatory and incentives scheme for 2020-21 to NGESO.

⁹ ESO roles guidance 2021-23:

https://www.ofgem.gov.uk/sites/default/files/docs/2021/03/eso_roles_guidance_2021-23_1.pdf

This letter and the Direction constitutes notice of the reasons for our decision pursuant to section 49A of the Electricity Act 1989.

Next steps

We appreciate the contribution stakeholders made during 2020-21. Stakeholder feedback was a key aspect of our annual incentive scheme for the ESO during 2018-21.

In April 2021, we introduced the RIIO-2 price control (2021-26) for the ESO.¹⁰ We have introduced a pass-through funding approach, supported by incentives to deliver value for money, which will enable the ESO to be agile and adapt quickly. The incentives framework will run over a two-year period (aligning with the business plan period) and is underpinned by the ESO Roles Guidance that sets out our expectations for ESO's activities and outcomes. We will evaluate the ESO's combined performance on outputs and costs, across the full spectrum of its roles and the incentives will provide the ESO with additional returns where the ESO has delivered exceptional performance. The ESO Performance Panel and Ofgem will assess the ESO's performance every 6 months. Stakeholder feedback will continue to be a key part of the framework. We strongly encourage stakeholders to continue engaging with the ESO and us to scrutinise the ESO's performance over the course of RIIO-2.

If you have any feedback on the ESO's performance throughout the course of 2021-22, including both positive examples of ESO performance and/or areas of concern, please contact us at: ESOpformance@ofgem.gov.uk.

If you have any questions on the contents of this letter, please contact us at the email address above.

Yours sincerely,

Eleanor Warburton

Deputy Director – Energy Systems Management & Security

For and on behalf of the Gas and Electricity Markets Authority

¹⁰ RIIO-2 Final Determinations: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Annex 1 – Detailed assessment of ESO performance over 2020-21

In this section, we have described our expectations for each role, the ESO Performance Panel's (the 'Panel') assessment of the ESO's performance¹¹ and have set out our key considerations when determining our scores and the ESO's financial incentive value.

Role 1: Control Centre Operations

- Principle 1.1: Support market participants to make informed decisions by providing user-friendly, comprehensive, and accurate information.
- Principle 1.2: Operate the system safely and securely, whilst driving overall efficiency and transparency in balancing strategies across time horizons.
- Principle 1.3: Coordinate effectively to ensure efficient system operation and optimal use of resources.

Our expectations under this role area

This role requires the ESO to support the market to balance the system as much as possible. Where the ESO does need to take actions to secure the transmission system, it should consider the impacts of its actions across time horizons, to ensure the actions taken drive overall efficiency. The ESO should coordinate effectively with other parties to deliver the most efficient and economic outcomes for the whole system.

ESO Performance Panel assessment of performance

- The Panel agreed on a score of 4. Overall, the Panel considered that the ESO's pandemic response was the predominant positive driver for Role 1. The ESO was able to adapt to unprecedented events, ensure business continuity and operate the system effectively. However, this was counter-balanced with the significant increase in balancing costs which remained high across the entire year. Therefore, the Panel reflected that, on balance, the ESO was currently within the lower range of this score.
- On plan delivery, the Panel considered that the ESO had performed well in meeting its commitments and delivering new initiatives given the added pressure of the pandemic. The new deliverables that were brought in to deal with the effect of the pandemic (including the use of ODFM, weekly transparency forums and the increased forecasting outputs on the data portal) had delivered consumer benefit. The Panel noted positive stakeholder feedback on the ESO's quality of engagement, but also noted that the transparency of the ESO's operational decision making could

¹¹ ESO Performance Panel End of Year report 2020-21: <https://www.ofgem.gov.uk/publications/eso-performance-panel-end-year-review-2020-21>

improve. The Panel were also concerned by a lack of confidence more generally in the ESO's forecasting accuracy.

- Going forward in 2020-21, the Panel would like to see evidence that the new initiatives (e.g., Frequency Risk and Control Report) are helping to improve transparency for stakeholders. Given the size and therefore importance of balancing costs, the Panel would also like to see stronger evidence to clearly substantiate that the ESO had taken actions to bear down on these costs and demonstrate that their actions are well prioritised to reduce or minimise overall balancing costs.

Our assessment of the ESO's performance and financial incentive reward

- We considered that the ESO exceeded baseline expectations and awarded the ESO a score of 4 for Role 1. We considered all the criteria equally when making our assessment as we considered all to be equally relevant for Role 1.
- Our conclusion was mainly driven by the ESO's response to the pandemic in ensuring system security whilst working with stakeholders to provide increased transparency of operational decision making. The main negative element was high balancing costs that continued even after the demand levels returned to close to normal levels.
- Plan delivery (where we considered the ESO's control room pandemic response) and stakeholder feedback were both considered to be exceeding expectations. The ESO's evidence of benefits and the metrics met baseline expectations.
- A score of 4 has an incentive range of £2m to £6m and a default incentive value of £4m.¹² Whilst we agreed with the Panel's overall score of 4, when viewing the package of evidence and each of the criteria holistically, we do not see strong evidence to justify moving the ESO up or down the incentive range. Relative to the Panel we have placed slightly more weight on the ESO's pandemic response and relatively less weight on the balancing costs metric.
- Therefore, we have calculated a Role 1 incentive reward of £4m based on the default incentive score of 4. We have set out more detail in relation to each criterion below.

Plan delivery

- We considered the ESO's control room response to the pandemic as part of this criteria. We recognise that the impacts of COVID-19 led to unprecedented challenges this year, especially for the ESO's management of the electricity system. The ESO adapted quickly to ensure business continuity, staff safety and system security. We recognise the difficult wider circumstances and significant extra effort control room staff made to ensure system security.

¹² See Annex 2: Table 3.

- Overall, the ESO completed 75% of the deliverables committed to be delivered in this incentive year. Alongside this, we recognise that the ESO had to reprioritise its deliverables and allocate resources toward additional deliverables in order to respond effectively to the pandemic.
- Out of the completed deliverables, we note that the following deliverables were all well received by stakeholders: Widen access to API (Application Programming Interface) System, More clarity of operational decision making and phases 1 and 2 of Power Available.
- We granted regulatory flexibility to the following Role 1 deliverables: Implement state of Energy Signal and competitively tendering black start contracts.¹³ We are satisfied, based on the information provided by the ESO that these deliverables experienced delays due to COVID-19 impacts that were outside of the ESO's control.
- We noted a few other delays and incomplete deliverables, but we are satisfied with the justification behind the majority of these, namely:
 - The Significant upgrades of IT systems to prepare for European Network Codes was not delivered due to complications arising from Brexit's impact on project TERRE¹⁴.
 - Transmission Outages, Generation Availability (TOGA) replacement was delayed due to the refinement of stakeholder requirements, user acceptance testing taking longer due to complexity and data validation and migration. The ESO has engaged well with industry on this deliverable, and we see this delay as appropriate.
 - Expand dispatch facility to handle a large number of small Balancing Mechanism Units, subject to market take-up was reported by the ESO as being delivered however the ESO have confirmed that the Q2-Q4 sub deliverables¹⁵ were not delivered as they were reprioritised due to the impact of COVID-19, wider access, and TERRE.
 - Improving information access was delayed due to issues within the ESO's control, but these were identified during the scoping of the project.
- Overall, we agree with the Panel's assessment that the ESO had performed well in meeting its commitments and delivering new initiatives given the major difficulties imposed by the pandemic. We considered that plan delivery exceeded baseline expectations as the positives (particularly the ESO's control room response to COVID-19) clearly outweighed the negatives.

¹³ We set out a process for the ESO to demonstrate necessary delays in 'lower priority' ESO activities to enable the ESO's response to the COVID-19 pandemic. Further details of the regulatory flexibility granted to the following Role 1 deliverables can be found here:

https://www.ofgem.gov.uk/system/files/docs/2020/05/ofgem_response_to_eso_COVID-19_impact_letter_may_2020_0.pdf

¹⁴ Trans European Replacement Reserves Exchange (TERRE) is the European implementation project for exchanging replacement reserves in line with the Electricity Balancing guideline. TERRE is assessed under Role 2.

¹⁵ Q2 - Complete the design stage for replatforming our existing multi-dispatch tool, Q3 - Replacement of existing dispatch optimiser with modern optimiser with capability to solve for more complex scenarios, including a larger number of small BM units and Q4 - Re-platforming our existing multidispatch tool delivery.

Evidence of benefits

- Overall, we considered the ESO's evidence of benefits to be in line with our expectations. The case studies provided by the ESO in the End of Year Report, when considered alongside the wider picture of consumer benefits delivered by the ESO this incentive year, met expectations. Of the case studies¹⁶:
- We note the progress made to deliver the second phase of Power Available. We consider this work will lead to benefits through greater access to ancillary markets for intermittent generation. We are pleased to see the ESO delivering solutions that support the ambition to operate the system carbon free and agree with the Panel that this will deliver future benefit.
- The ESO has continued to increase accessibility to the Balancing Mechanism (BM) through the implementation of the Application Programming Interface System. We see the reduction of barriers to entry for future smaller market participants as the ESO continuing to make progress. In previous years we have awarded the ESO credit for the future benefits associated with the wider access workstream.¹⁷ We note that the ESO has not sufficiently demonstrated how the benefits associated with the API go beyond those benefits already rewarded.
- The Transmission Network Topology optimisation trial is an example of the ESO seeking innovative new approaches to reduce the cost of constraints. We are pleased to see the ESO undertake this trial given the projected trend of substantial increases in constraints costs. However, the estimated future benefits are only possible should the one-year trial be made permanent.
- More widely the improvements in operational transparency, (through the Operational Transparency Forums¹⁸ and the Dispatch Transparency Tool¹⁹) and the improvements to forecasting (through the Platform for Energy Forecasting deliverable²⁰) should deliver benefits through a more informed market.
- We have also considered the future benefits that will be delivered upon delivery of the second phase of Inertia measurement and the final part of the Deliver competitively tendered black start contracts being completed.

Stakeholder feedback

- Stakeholder feedback was broadly positive and an improvement from previous years. We found there to be notably more positive stakeholder feedback than negative and so we considered that the ESO had exceeded expectations.

¹⁶ Further information on the ESO's case studies can be found in their end of year report:

<https://www.nationalgrideso.com/document/191446/download>

¹⁷ See page 12 and page 14 on how wider access was considered in the incentive decision 2019-20:

<https://www.ofgem.gov.uk/publications/direction-electricity-system-operators-financial-incentive-2019-20>

¹⁸ The Operational Transparency Forums are the ESO's weekly forum to engage with stakeholders on operational decision-making processes.

¹⁹ The Dispatch Transparency Tool publishes a dataset onto the ESO Data Portal on a weekly basis to provide additional insight into the actions taken in the Balancing Mechanism (BM).

²⁰ The Platform for Energy Forecasting (PEF) project aims to re-design the ESO's forecasting processes, using advanced modelling techniques, automation, and machine learning.

- The ESO's quality of engagement with its stakeholders on operational decision making was strongly commended, especially during the times of greatest uncertainty over the summer. The Operational Transparency Forums have received regular and widespread positive feedback. The frequency of the forums and added transparency around system operation actions are particularly welcome.
- The majority of stakeholders recognised that the Open Data Portal is a positive step towards greater transparency. However, there were several areas where stakeholders requested further transparency on the ESO's decision-making process:
 - Lack of transparency of SO-SO trades over the interconnectors and the lack of detail regarding schedule 7 trades.
 - Cost information regarding BM actions, with lack of explanation as to why different documents do not reconcile.
 - Lack of transparency concerning the warnings issued over the winter.
 - Lack of timely information regarding unplanned outages of transmission assets.

Performance metrics

- We consider the ESO's Role 1 performance metrics outturn to be meeting baseline expectations.
- We share the concern of the Panel that balancing costs were significantly high (metric 1A: balancing cost management). The ESO's outturn was around 40% more than the previous year's annual outturn, with the ESO spending over £100m every month this year. Notably, balancing costs did not fall once demand returned to near normal levels and were above the benchmark for 11 of the 12 months. In assessing this, we have considered:
 - The impact of the COVID-19 restrictions on reducing demand levels to, at times, 20% lower than the ESO would have otherwise expected over the summer. This required unprecedented levels of intervention by the ESO over the summer months. It could have also caused delays to outages that would have been taken in summer 2020 but were instead pushed into winter 2020-21, potentially leading to tighter winter margins.
 - We recognise that during the summer, the ESO was acting to prioritise security in an unfamiliar, challenging set of circumstances and consider that the actions that the ESO took in the short term to maintain system security were, overall, reasonable.
 - Over winter we recognise that there was a clear change in market participants' bid and offer behaviour in respect to tight margins. This caused costs in the BM to be higher than would have been reasonably forecast.
- The ESO's demand forecasting was reported to be in line with expectations and the wind forecasting was reported to be exceeding expectations (metric 1B: Energy

Forecasting accuracy).²¹ Our analysis shows that the ESO's demand forecasting accuracy over 2020-21 has largely remained the same as 2018-19 and 2019-20. Given the demand uncertainty this year, we recognize the ESO's strong performance in keeping demand forecasting errors in line with previous, more predictable years. We were unable to conclude that wind forecasting accuracy has exceeded expectations as reported by the ESO because of inconsistencies in how the ESO reported the data.

- There were no excursions for either voltage or frequency outside of statutory limits (metric 1C: security of supply) and we recognize the ESO was able to achieve this against the backdrop of challenging conditions this year, so we agree that this is exceeding expectations.
- On system access management (metric 1D), we agree that the ESO has met baseline expectations. The ESO stated that COVID-19 restrictions caused a strain on the proposed outage plan during the summer months with TOs having to adapt the way they worked on sites.

Role 2: Market development and transactions

- Principle 2.1: Ensure the rules and processes for procuring balancing services maximise competition where possible and are simple, fair and transparent.
- Principle 2.2: Promote competition in wholesale and capacity markets.

Our expectations under this role

This role requires the ESO to encourage and facilitate competition in all markets that it can affect. This includes the balancing and ancillary services markets where the ESO is the lead architect and principal buyer and includes the remaining markets that the ESO can affect (i.e., wholesale and capacity markets).

ESO Performance Panel assessment of performance

- The Panel agreed on a score of a 3. The Panel saw some instances of strong performance but also saw instances of weaker performance. Overall, the Panel saw the ESO's performance growing stronger in the second part of the year.
- On plan delivery, the Panel reflected that the ESO had largely met baseline expectations. In terms of delivering market reform this year, there were some aspects that were positive, but there were also some inconsistencies and aspects which could be improved.

²¹ Although we note that the ESO had to recreate some of the performance data mid-year using more reconciled numbers. Therefore, the ESO performance looks better at the end of year than it did at the mid-year stage.

- On stakeholder feedback, the Panel noted the positive views on the ESO's adoption of a 'co-creation' approach with industry, particularly on market reforms. The Panel also considered the BSUoS billing error which had significant negative impacts on market participants.
- On metrics, the Panel noted the improvement in stakeholder satisfaction on code administration but noted the lack of stakeholder confidence in the accuracy of BSUoS forecasts.
- On evidence of benefits, the Panel recognised that the ESO did well by responding proactively and quickly to equip the control room with new tools during the pandemic (for example through the urgent code modifications). At the same time, they considered that the Markets Roadmap to 2025²² needs greater clarity about delivery outcomes to give confidence that benefits would be realised.
- Going forward, the Panel would like to see strong prioritisation of on-the-ground implementation of clearly defined, integrated market reforms, more consistent outcomes from the ESO's co-creation activities and improved accuracy of BSUoS forecasts.

Our assessment of the ESO's performance and financial incentive reward

- Overall, we considered that the ESO had met our baseline expectations and awarded the ESO a score of 3.
- In addition to the many aspects that met our expectations, there were positive areas and negative areas which were considered to balance out overall.
- The ESO had responded and acted upon the mid-year feedback it received and it has improved since the mid-year stage. We agree with the panel that the ESO's performance was growing stronger in the second half of the year. The key positives for this role were the ESO's co-creation approach with industry, implementation of new balancing products, and its improved stakeholder satisfaction with its code administrator role. The negative drivers and areas for improvement were the ESO's cross border balancing arrangements and the significant BSUoS billing error, which did not meet our expectations.
- We agreed with the panel's assessment. The ESO's plan delivery and evidence of benefits were largely in line with baseline expectations, as set out in our formal opinion. The ESO's performance metrics and stakeholder feedback were mixed and so balanced out to meet baseline expectations.
- A score of 3 has an incentive range of -£2m to £2m and a default incentive value of £0m. We have decided on a value of £0m as we considered the positives and negatives balanced out overall.

²² This roadmap sets out the ESO's ambitions, principles, and process to transform its ancillary service markets: <https://www.nationalgrideso.com/research-publications/markets-roadmap-2025>

Plan delivery

- In our formal opinion we noted that the ESO had prioritised the right areas in its Forward Plan, but the majority of deliverables were business as usual activities that we expected the ESO to be undertaking. The ESO reported that 85% of its Role 2 deliverables this year have been delivered during this period.²³ We considered that the majority of those delivered on time were in line with our baseline expectations. There were some instances of above baseline performance, but this was equally matched with instances of below baseline performance and therefore the ESO's performance against the plan delivery criteria met our expectations overall.
- There were some noteworthy deliverables that warrant further comment:
 - **Dynamic containment** ("DC"): The ESO delivered a soft launch of DC-low frequency on 1 October 2020, meeting the implementation timelines required to help mitigate a security of supply issue that had been identified. Delivery of DC-low frequency was expedited, with the ESO demonstrating agility in how it transitioned this product from its auction trial to a live soft launch. Nevertheless, we believe that the need for an expedited delivery, with associated teething issues, could have been avoided if the ESO had identified and addressed the security of supply issue in question much further in advance. Stakeholders also noted that they felt excluded from discussions due to the rapid turnaround. Finally, we observed some positive evidence of the ESO learning and improving: the initial launch struggled to procure a sufficient volume of response and the ESO reacted to this by working with market participants to improve the service. On balance, we consider that this deliverable met our expectations.
 - **Optional downward flexibility management** ("ODFM"): During summer 2020, the ESO implemented ODFM at pace to meet operational needs. Initially we considered the ESO's response to the pandemic by delivering ODFM at pace to be positive. However, we note that in winter 2020-21, the ESO was reluctant in committing to reintroduce ODFM, despite a growing need for the contingency due to the continued lockdowns. This delay led to a compressed timeline for the eventual reintroduction of ODFM and caused uncertainty in the market. After its conception, both Ofgem and stakeholders expressed concern that ODFM was not incorporated into cash-out arrangements. This was only addressed at the last moment before the reintroduction, following repeated feedback from Ofgem and stakeholders. We consider that the ESO could have been more proactive in responding to feedback and addressing concerns. On balance the ESO met our expectations for this deliverable.

²³ Of those deliverables that were incomplete, 2 were partially delivered, 1 was reprioritised, and one was incomplete.

- **Cross-border balancing arrangements** (TERRE²⁴): Even when taking into consideration the difficulties²⁵ presented by the COVID-19 pandemic, and the uncertainty's associated with GB/EU trading arrangements, we believe that the ESO's performance in this area up to the beginning of October was below our expectations. Since publishing our open letter on the ESO's TERRE implementation,²⁶ the ESO's engagement with industry improved and it offered stakeholders a small degree of certainty within an inherently uncertain situation. As a result, we have concluded that the ESO's performance was below expectations during the first six months and moved up to meet expectations over the final six months.
- **Markets Roadmap to 2025:** the delivery of the Markets Roadmap to 2025 was a welcome deliverable. Generally, it provided much greater clarity on the ESO's milestones for new product developments and how its planned reforms fit together. Although this plan fulfils the ESO's deliverable to produce a strategy for the future of reactive power, it was not clear how the ESO intends to integrate learnings from all reactive power projects²⁷ to create a coherent plan for developing reactive power services. Overall, we consider that this roadmap outlines a coherent set of plans for all the services that the ESO procures in one place – in line with the baseline expectations set out in our formal opinion.

Evidence of benefits

- Overall, we considered the evidence of benefits to be in line with baseline expectations. As mentioned previously, the majority of the ESO's Role 2 deliverables met our baseline expectations. The benefits associated with these deliverables are also in line with our expectations. In order to outperform on this criterion, it should be clear that the ESO has sought to maximise benefits.²⁸ In our formal opinion we said, that to exceed our expectations the ESO would have to deliver tangible new markets and product developments.²⁹ We agree with the Panel that the ESO did well by responding proactively and quickly to equip the control room with new tools during the pandemic. We believe that it's these types of deliverables, as well as a

²⁴ Trans European Replacement Reserves Exchange ("TERRE").

²⁵ The ESO reported that this work required control room access, which was not possible during lockdown.

²⁶ Our open letter on the ESO's TERRE implementation can be found at the following address:
https://www.ofgem.gov.uk/publications-and-updates/open-letter-delays-implementation-terre-gb?utm_medium=email&utm_source=dotMailer&utm_campaign=Daily-Alert_06-11-2020&utm_content=Open+letter+on+the+delays+to+the+implementation+of+TERRE+in+GB&dm_i=1QCB,74AR,0,M74DRI,SSILL,1

²⁷ E.g., ESO's pathfinders, Power Potential, DNO boundary investigations.

²⁸ Page 25 of our ESORI guidance:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/esori_guidance_document_2020-2021_final.pdf

²⁹ Page 9 of our Formal Opinion 2020-21:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/ofgem_formal_opinion_2020-21.pdf

prioritisation of on-the-ground implementation of market reforms, that have the potential to maximise consumer value by reducing balancing costs, if executed well.

- Nevertheless, we note that the ESO has demonstrated some examples of initiatives that could deliver benefits in the future through the three cases studies presented in its end of year report. Our views on each of the ESO's case studies are provided below:
 - In line with Ofgem and the E3C's³⁰ recommendation, the ESO developed the Security and Quality of Supply Standards ("SQSS") modification GSR027, which introduced a requirement to produce a Frequency Risk and Control Report ("FRCR"). The ESO submitted the first version of FRCR to us on 1 April 2021, and we consider that the report met our expectations.
 - The ESO's work on streamlining code governance (specifically Grid Code modification GC0131) was welcomed, and we believe that GC0131 will be beneficial for the quality of service offered by the code administrator. However, we have not seen a strong demonstration of this workstream delivering additional consumer benefits.
 - The ESO's "Reserve from Storage Trial" appears to be a useful initiative and we anticipate that it has produced valuable learning that will be beneficial for future reserve reforms. However, it is unclear how the ESO will apply any learning from the trial to its planned reserve reforms.

Stakeholder feedback

- Stakeholder feedback for Role 2 was mixed and overall, we consider that the positives balanced out the negatives. Therefore, this met baseline expectations.
- The general theme from stakeholder feedback was that the ESO could do more to consider the impacts of its actions on market participants. We agree with the Panel's view that the ESO's adoption of a 'co-creation' approach with industry, particularly on market reforms, was a positive development to address this feedback. This change within the ESO became more apparent during the latter half of the regulatory year. We expect that this approach will continue over the course of RII02 and will help the ESO to identify and respond to its impact on market participants.
- Stakeholders welcomed the ESO's co-creation approach but noted that its consultation approaches appeared to be somewhat inconsistent in practice and they would have liked more time to provide consultation feedback on new ESO products that were introduced this year. Stakeholders also felt that the ESO could have better taken on board their feedback, particularly in relation to ODFM and dynamic containment (stakeholders expressed frustrations with the ODFM cash-out issue mentioned above in the Plan Delivery section. Stakeholders also thought the rushed

³⁰ The Energy Emergencies Executive Committee.

nature of the DC 'soft' launch caused a number of issues but note that the ESO has updated DC and is actively seeking feedback on the other dynamic products).

- Stakeholders welcomed the commitments set out in the Markets Roadmap to 2025 and considered these to be ambitious. However, stakeholders expressed an interest in wanting the ESO to move quicker toward day-ahead procurement of balancing services.
- There was positive feedback towards the ESO's role as code administrator, particularly the ESO's analysis and work during a busy schedule. Suggested improvements included better coordinating on similar mods to avoid inefficiencies, improving the diversity of industry change working groups and reducing the complexity of the CUSC processes.
- Stakeholders would like more information provided to explain BSUoS forecasts. There were also complaints about the recently identified £44m BSUoS under recovery error. Stakeholders were disappointed with how this was communicated to industry and did not believe that the ESO fully considered the impact on market participants. They also noted concerns about the robustness of ESO's processes as this under recovery went undetected for several months. We agree that this issue highlighted a lack of consideration for the impact on market participants, as well deficiencies in the ESO's processes, and we consider that the ESO fell below our expectations in this instance.
- Stakeholders believed that the communication on TERRE had not been conclusive and there is a request for further information to be provided.

Performance metrics

- The ESO's Role 2 performance metrics were mixed.
- The ESO had mixed results on the reform of balancing services markets (metric 2A: Reform of Balancing Services Markets). The ESO met its procurement targets for frequency response and constraints but failed to meet them for Reserve, Black start, and Reactive power. However, we note the ESO's progress in completing competitive tenders in 5 out of 6 black start zones.
- The ESO reported that it exceeded expectations on its code administrator stakeholder satisfaction (metric 2B: Code Admin Stakeholder Satisfaction) and this was largely supported by the stakeholder feedback we received. We note that in the absence of the CACOP survey, we can measure the ESO's 2020-21 performance against its previous years' performance, but it is more difficult to compare this year's performance to other code administrators. The ESO's reported code administrator improvements in 2020-21 appear to put the ESO in line with the

average code administrator stakeholder satisfaction scores as reported in the most recent (2019) CACOP survey.

- The ESO exceeded expectations on its charging futures forum (metric 2C: charging futures), which continues to be well-received and ably facilitated.
- On the BSUoS forecasting metrics (metrics 2D and 2E), we acknowledged that factors outside of the ESO's control contributed significantly to the performance of the BSUoS metrics and so we placed less weighting on the outturn of metrics and more on the narrative.³¹ We understand that BSUoS forecasting has been difficult this year due to the pandemic causing low demand and high constraints costs alongside tight margins in the winter.
- Taking all of this into consideration, for the Role 2 metrics, we believe that the ESO performed in line with our baseline expectations.

Role 3: System insight, planning and network development

- Principle 3.1: Coordinate across system boundaries to deliver efficient network planning and development.
- Principle 3.2: Facilitate timely, efficient, and competitive network investments.

Our expectations under this role

Under this role, the ESO is expected to coordinate effectively with other parties to deliver the most efficient and economic outcomes for the whole system. This includes coordinating with other parties across network boundaries when undertaking network planning and development. The ESO should also facilitate competition to ensure value for consumers and to drive innovation.

ESO Performance Panel assessment of performance

- The Panel agreed on a score of 3 and reflected that overall, the ESO was currently within the higher range of this score. The Panel focussed on plan delivery, stakeholder views and evidence of benefits.
- On plan delivery, the Panel recognised that the ESO had undertaken significant work to deliver its Early Competition Plan, showed positive leadership on the Loss of Mains Programme, opened the Network Options Assessment process to third party solutions and made progress through the Pathfinders. These positive elements of delivery were counter-balanced with a view that there appeared to be limited evidence of the Regional Development Programmes and NOA third-party solutions

³¹ Page 20-21 of the Formal Opinion:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/ofgem_formal_opinion_2020-21.pdf

making progress during 2020-21 and, overall, there had been insufficient focus on how the discreet Role 3 activities come together as a coherent whole.

- The Panel recognised that stakeholder feedback was, overall, in line with baseline expectations. Stakeholders were particularly positive on Open Networks and whole system engagement but there was mixed feedback on Pathfinders engagement, particularly on scope, roles, and timings.
- On evidence of consumer benefits, the Panel reflected on the lack of tangible outcomes from new initiatives but noted that several Role 3 deliverables should deliver consumer benefit in the future.
- Going forward, the Panel expects to see the ESO make a step-change in providing leadership and signposting to industry what needs to happen to optimise future system development. This also includes providing greater clarity on how the ESO's Role 3 activities form a coherent package, and that alternative non-network solutions are fully considered. The Panel expect the ESO to develop links between Role 3 activities and Role 2, in order to progress from provisional learning-by-doing activities into established market processes.

Our assessment of the ESO's performance and financial incentive reward

- We have awarded the ESO a score of 3.
- Overall, we consider that the ESO had largely met our baseline expectations for this role, with some elements of outperformance. We consider that plan delivery slightly exceeded baseline expectations. Stakeholder views were mixed, which balanced out to meet baseline expectations. The ESO's evidence of benefits also met our baseline expectations.
- We recognised it may be difficult to design metrics for this role. Previously we said this places greater emphasis on deliverables and progress against long-term aims.³² Therefore, when carrying out our evaluation we focussed more on plan delivery, evidence of benefits and stakeholder views.
- A score of 3 has an incentive range of -£2m to £2m and a default incentive value of £0m. We agree with the Panel that the ESO is in the higher end of a 3. We have decided on a reward of £1m. We have used the Panel's recommendation and the ESO's plan delivery during a challenging year to move them up within the incentive range.

Plan delivery

³² Formal Opinion 2019-20, page 10: Increasing the pace of some of the projects in this area could realise significant consumer savings which could far outweigh the additional resource cost.

https://www.ofgem.gov.uk/system/files/docs/2019/05/ofgem_formal_opinion_on_eso_forward_plan_2019-21.pdf

- We consider that the ESO has performed slightly above baseline expectations on plan delivery. The ESO delivered approximately 75% of its deliverables on time this year. This included some completed milestones which we believe are particularly novel and challenging, including the NOA pathfinders. In other areas the ESO's completed deliverables mostly met our expectations, although this was not the case for all deliverables.
- The ESO provided some mitigating circumstances for its delayed deliverables, but in some cases, it was still unclear what progress had been made in practice (particularly on the Regional Development Programmes and the single connections platform). Although we believe Role 3 should have been the least impacted by COVID-19, we have given the ESO some leeway on this given the general disruption caused by the pandemic.
- A summary of our assessment of the most notable deliverables is as follows:
 - **NOA Pathfinders (stability and voltage):** we consider the ESO should be given credit this year for continuing to make progress on pathfinders, as they are a key step towards delivering full competition between all types of solutions to network needs. The voltage and stability pathfinders have continued to unearth challenges and complex questions this year, and the ESO has been proactive in raising solutions to regulatory issues with us. In some cases, emerging challenges and issues have led to delays and disruption to parties. However, we do not think the ESO should be unduly penalised for this when it is embarking on new and challenging initiatives. Overall, these deliverables therefore exceeded our expectations this year. Going forward, pathfinders should be more established. To continue to exceed our expectations, we expect the ESO to learn lessons from this year, anticipate more issues in advance, and resolve these prior to launching competitions.
 - **NOA Pathfinders (constraints):** at the beginning of the year, we said we expected to see open, fair competition and a level playing field for all types of participants in pathfinders as a baseline expectation. Whilst the ESO has made welcome progress on Phase 1 of this pathfinder, it is restricted to a small subset of solutions. We believe the ESO could have done more to expand the constraints management pathfinder to more solutions.
 - **Loss of Mains protection setting programme:** we said at the start of the year that the ESO's continued support to this programme is a high baseline priority given its long history and the scale of costs at stake. We believe the ESO has shown increased leadership and made good progress on this programme this year and has therefore met our baseline expectations.
 - **ENA Open networks:** we said in our formal opinion the ESO should take a proactive and collaborative role in the Open Networks programme to meet

our baseline expectations. Over the last six months of 2020-21 we believe the ESO increased its engagement and has demonstrated these expectations.

- **Early competition model:** the ESO followed a robust process and carried out strong engagement on this project, in line with our expectations. To exceed expectations, we would have expected to see more thinking on how Early Competition fits within an enduring long-term planning process, including its links with the pathfinders.
- **Regional Development Programmes (RDPs):** in our formal opinion we noted significant previous delays on RDPs and stated that any further delays should be clearly evidenced. We do not think the ESO has demonstrated sufficient tangible progress on RDPs this year. However, we have given the ESO some leeway on this given the pandemic, and because of the RDPs dependence on contributions from other parties.

Evidence of benefits

- Overall, we consider that the ESO has met our expectations for evidence of benefits. The ESO has demonstrated some positive examples of initiatives that will deliver benefits in the future through the three cases studies in its end of year report. However, when we consider the ESO's performance more widely, we think there are some key areas of high consumer value which have not been sufficiently robustly tackled. In particular, we agree with the Panel that the ESO has not sufficiently set out how it will tackle growing constraints costs, or how its individual Role 3 activities contribute to an overall network planning vision. It is therefore not clear to us that ESO has sought to maximise consumer value under this role.
- A summary of our views on the case studies³³ include:
 - The ESO showed how process improvements it made on the Pennines Pathfinder will deliver benefits through more efficient pathfinder procurement volumes. We believe the ESO should earn some credit for this, although we do also expect a level of incremental process improvement as the pathfinders evolve. We also note that changing timelines have created disruption for some parties which can create wider industry costs.
 - The Northern England and Scotland Operability Study 2020 is a good example of the ESO working flexibly to react to changing circumstances to deliver valuable analysis in short timelines, which should help lower future costs.
 - The ESO's additional FES reports in 2020-21 are positive examples of the ESO seeking to go beyond its historical insight reporting to help influence the best pathway to Net Zero. We feel this is evidence of the ESO taking some

³³ More information on the Role 3 case studies can be found in the ESO's end of year report: <https://www.nationalgrideso.com/document/191446/download>

steps to put its ambition to 'lead the debate' into practice. To have more strongly exceeded expectations, we would like to have seen more specific examples of how the FES Bridging the Gap report influenced the ESO's future plans in practice.

- We consider that these small positive examples of the delivery of benefits are ultimately offset by a lack of progress on future constraints. This is a key area where the Panel and us have previously stressed the need for progress. Constraints costs are predicted to grow over the next decade and will have a material impact on consumer costs. There are many drivers of constraints costs, including those the ESO can directly influence (assessment and procurement processes), and those it has less direct control over (wholesale market design and the regulatory regime for planning and connections). On the former, we consider the ESO should have made more demonstrable progress during 2020-21 on initiatives such as the constraints management pathfinder (CMP) and NOA methodology. On the latter, the ESO is uniquely positioned to provide its expertise on the key drivers of constraints, and we think more could have been done to robustly analyse the biggest drivers and propose well considered solutions. We agree with the Panel that the ESO's five-point plan in March did not provide enough in these areas.
- We also agree with the Panel that to exceed expectations the ESO should clearly show how its individual Role 3 activities are working towards a joined-up overall network planning vision. We welcome the progress the ESO is making on discrete projects such as the pathfinders, NOA methodology and Early Competition plan. However, we expected to see more this year on how these initiatives fit together within a wider, integrated network planning process. In particular, at the start of the year we said we expected to see progress to fully integrate pathfinders into core network planning processes. We do not think there is currently a clear, joined-up process to assess the benefits of non-traditional providers of medium/long term thermal constraints solutions, or a clear route to market for these providers.

Stakeholder views

- We consider the ESO has met baseline expectations in this area. The stakeholder feedback we have received has been mixed and was not clearly skewed in an overall positive or negative direction.
- Stakeholders expressed support for the ESO's Role 3 initiatives, including the pathfinders and RDPs, but many also made comments on areas for improvement.
- Some stakeholders noted improvement in the ESO's engagement in Open Network whilst others think that the ESO should go further still, particularly on the standard contract work.

- Stakeholders continued to welcome the ESO's insight documentations, noting improvements in readability, although some expressed the need for analytical conclusions to be followed up with tangible implementation plans.
- Through our call for evidence and other engagement, several parties have expressed concerns to us about the ESO's NOA pathfinder process. These stakeholders expressed a need for earlier engagement, enhanced communication, and more up-front process development. We agree the ESO has some lessons to learn on the process to date. However, we also believe that the pathfinders are novel and challenging, and that it is not possible to anticipate all issues that arise. We have therefore given the ESO some leeway in this area. Going forward, the pathfinders will be less novel, and we expect the ESO to address lessons learned from this year. As a result, we will expect the ESO to engage earlier, anticipate more issues, develop a more certain process, and make fewer timeline changes.

Performance metrics

- We placed less weight on this criterion compared to others, as robust metrics have been hard to develop for Role 3. Overall, performance against the metrics was mixed, and we consider the ESO has met baseline expectations in this area.
- The ESO reported that it was exceeding expectations for the first part of its NOA performance metric, but below expectations for the second part. Having assessed the supporting narrative, we do not think there are strong enough examples to suggest that the ESO has either fallen below or gone beyond our expectations on the NOA this year.
- The ESO reported that it was below expectations on customer satisfaction for connections. It provided some mitigating circumstances for this (a 22% rise in applications and the limited number of responses from stakeholders to the survey). We recognise that the pandemic may have made it harder to react to changing circumstances and we factored this into our assessment of this metric.

Annex 2 - The evaluation process and determination of a financial incentive reward/penalty

We require the ESO to participate in the incentives framework in line with our ESO Reporting and Incentive (ESORI) Arrangements Guidance.³⁴ We outline our expectations of the ESO for each role in our Roles and Principles Guidance³⁵. This is underpinned by the ESO's licence conditions. Our baseline expectations of the ESO will adapt with the changing energy system. We expect continuous improvement as past achievements become the new baseline and should be built upon for future success.

Table 2. ESO roles and principles 2020-21

Role	Principle
Role 1: Control Centre Operations	Principle 1.1: Support market participants to make informed decisions by providing user-friendly, comprehensive, and accurate information.
	Principle 1.2: Operate the system safely and securely, whilst driving overall efficiency and transparency in balancing strategies across time horizons.
	Principle 1.3: Coordinate effectively to ensure efficient system operation and optimal use of resources.
Role 2: Market development and transactions	Principle 2.1: Ensure the rules and processes for procuring balancing services maximise competition where possible and are simple, fair and transparent.
	Principle 2.2: Promote competition in wholesale and capacity markets.
Role 3: System insight, planning and network development	Principle 3.1: Coordinate across system boundaries to deliver efficient network planning and development.
	Principle 3.2: Facilitate timely, efficient, and competitive network investments.

Before the start of the regulatory year, the ESO must publish a Forward Plan in line with these expectations. This plan outlines the key actions the ESO intends to take to maximise benefits for consumers, against each role. The plan must be based on stakeholder engagement and must include deliverables and performance metrics which the ESO must report on throughout the year.

³⁴ ESO Reporting and Incentive (ESORI) Arrangements guidance document for 2020-21:
https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/esori_guidance_document_2020-2021_final.pdf

³⁵ More information around the ESO's roles and principles can be found at:
https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/eso_roles_and_principles_guidance_2020-21.pdf

The ESO reports to Ofgem and to the ESO Performance Panel. The Panel is made up of independent experts and industry representatives and plays a central, advisory role. The Panel and Ofgem challenge the ESO's plans before the start of the year and assess the ESO's performance at the mid-year and end-of-year stage.

The following criteria is used to evaluate the ESO's performance:

- Forward Plan ambition & delivery
- Evidence of benefits
- Stakeholder evidence / feedback
- Performance metrics and justification

When assessing the ESO's performance the Panel and Ofgem provide a score for each role on a scale of one to five, where:

- 1 is "Weak"
- 2 is "Poor"
- 3 is "Average" (or "baseline expectations")
- 4 is "Good"
- 5 is Excellent.

More information on this evaluation process can be found at in Chapter 3 of our ESORI Guidance document. In some instances, we wanted to reflect more detail in the scores. For example, a score of 3 denotes that the ESO is meeting baseline expectations, but the ESO's performance for a particular role may be, on the whole, just above expectations but not sufficient to be scored a 4. This is reflected throughout the report as a 'high 3' (or alternatively a 'low 3' to signal performance that was slightly below expectations but not considered to be a 2). This distinction provides further clarity on how we evaluated the ESO.

Calculation of financial incentive reward / penalty

The maximum reward/penalty the ESO can achieve for 2020-21 is up to ±£30m. We have split this equally among each of the three roles (±£10m per role).

To determine the overall reward/penalty outlined in our decision and direction, the following three-step process applies:

- **Panel's recommendation.** The Panel use the criteria above to assess the ESO's performance and provide a score out of five for each role.
- **Ofgem's assessment.** Using the evidence available to us, we carry out our own evaluation and scoring (using the same criteria as the Panel). We will take the Panel's recommendation into account, but we do not have to follow the Panel's view

(this may apply, for example, if we have taken into consideration other evidence not available to the panel).

- **Calculation of financial incentive reward/penalty.** Each score corresponds to a default incentive payment or penalty and has an associated incentive range as shown in Table 3. Any adjustments we decide upon in our final assessment will remain within these incentive ranges determined for each role. We will consider the Formal Opinion, the evaluation of consumer benefits/costs and any close scoring decisions when considering whether to move the ESO up or down within this incentive range.³⁶ Any adjustments to the reward / penalty from the default amount will be made by calculating the mid-point from the default value to the upper or lower end of the incentive range. If a further adjustment is warranted, we will adjust the incentive value to the upper or lower end of the incentive range. For example, the ESO may get a score of 4 for Role 1. Therefore, the default amount associated with a score of 4 is £4m. If upon assessing the evidence, we consider that the ESO has demonstrated sufficient performance to warrant a higher incentive reward, then the ESO's incentive value will be moved up, and could receive either £5m (the mid-point from the default value to the upper limit of the incentive range) or £6m (the upper limit of the incentive range). Where we have decided to adjust the ESO's financial reward/penalty, we have set out our reasoning in Annex 1.

As is noted above, a score of 3 or "average" performance warrants a payment value of zero. Within this, there is an incentive range that is positive and negative, corresponding to a 'high 3' and 'low 3' respectively. The ESO will only earn a financial reward for going above and beyond the "average" performance level, by delivering on actions that provide additional benefits to consumers.

This incentive payment decision is additional to the financial return achieved through the ESO's RIIO-1 price control. We expect a high level of service from the ESO, based on commitments under RIIO-1 and obligations and expectations in the ESO's licence.

Table 3. Table of relationship between scores and the incentive reward/penalty for each role.

Score	1	2	3	4	5
Default incentive payment (£m)	-8	-4	0	4	8
Incentive range (£m)	-10 to -6	-6 to -2	-2 to 2	2 to 6	6 to 10

³⁶ Pages 35-36 of the ESORI guidance 2020-21 describe the adjustment process in more detail: https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/esori_guidance_document_2020-2021_final.pdf

Annex 3 – Direction on the ESO’s financial incentive for 2020-21

For and on behalf of the Gas and Electricity Markets Authority

DIRECTION PURSUANT TO PARAGRAPH 4M.19 OF SPECIAL CONDITION 4M OF NATIONAL GRID ELECTRICITY SYSTEM OPERATOR LIMITED’S ELECTRICITY TRANSMISSION LICENCE IN RELATION TO THE ELECTRICITY SYSTEM OPERATOR INCENTIVE ARRANGEMENTS

Whereas:

1. National Grid Electricity System Operator Limited (“NGESO”) is the holder of an electricity transmission licence (the “Licence”) granted or treated as granted under section 6(b) of the Electricity Act 1989 (the “Act”).
2. Special condition 4M (Electricity System Operator Reporting and Incentive Arrangements), Part F (Incentive payments) of the Licence, that was in effect on 31 March 2021, allows the Authority to direct the value of IncPayExt_t , in respect of NGESO’s incentive performance in Relevant Year $t-1$, by July in Relevant Year t , as determined under this condition and the ESORI Arrangements Guidance Document.

Therefore:

In accordance with Special Condition 4M.19, the Authority hereby directs the incentive value of IncPayExt_t in respect to the regulatory and incentive scheme for 2020-21, to be £5m.

This Direction and the letter to which it is attached constitutes notice of the reasons for the decision pursuant to section 49A of the Act.

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Eleanor Warburton – Deputy Director, Energy Systems Management & Security

For and on behalf of the Gas and Electricity Markets Authority

Date: 30/07/2021