# Report

## Ofgem's Six-Month Review of ESO Performance 2021-23

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The RIIO-2 price control for the Electricity System Operator (ESO) covers the period 2021-26. The ESO's business plan period and incentives framework run over a two-year period (2021-23).

As part of the incentive framework for the ESO's RIIO-2 price control, the ESO Performance Panel and Ofgem will assess the ESO's performance every 6 months.

**We are publishing this report, detailing Ofgem's assessment of the ESO's performance at the six-month review stage. This six-month review covers the first six months of the RIIO-2 BP1 period, from April 2021 to September 2021.**

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## RIIO-2 ESO Incentive Framework

### Background

In April 2021, we introduced the RIIO-2 price control for the ESO (covering the period 2021-26).[1] This consists of a pass-through funding approach, supported by performance-based financial incentives to deliver value for consumers. The incentives framework runs 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 the ESO's activities.[2] 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 (the "Panel") continues to play a central role in the ESO's RIIO-2 price control.

The Panel and Ofgem will assess the ESO's performance every 6 months, identifying areas where the ESO is performing in line with expectations, where it is exceeding expectations and where it is not meeting expectations. At this point in the regulatory cycle, we are providing the ESO with early feedback on its performance and the opportunity to act on this and make any necessary improvements during the remaining months of the scheme.

### Approach

This six-month review covers the first six months of the first Business Plan period (BP1) from April 2021 to September 2021. We followed the process described in Chapter 3 of the ESORI (Electricity System Operator Reporting and Incentive Arrangements) Guidance[3] to assess the ESO's performance in relation to each role, taking into account our feedback in the RIIO-2 Final Determination (delivery schedule grading).[4] We assessed the evidence provided by stakeholders[5], the ESO[6] and collected by us throughout the first six months and used the prescribed evaluation criteria to provide scores for each of the ESO's roles. We have used this score to also communicate our expectation on the ESO's projected two-

[1] RIIO-2 Final Determinations – ESO Annex: https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_eso_annex_revised.pdf
[2] ESO roles and principles 2021-23: https://www.ofgem.gov.uk/sites/default/files/docs/2021/03/eso_roles_guidance_2021-23_1.pdf
[3] ESORI guidance document 2021-23: https://www.ofgem.gov.uk/sites/default/files/2021-06/Electricity%20System%20Operator%20Reporting%20and%20Incentives%20%28ESORI%29%20Guidance%202021-23%20%28REVISED%29.pdf
[4] Ofgem graded the delivery schedule for each role, with an explicit grading (1-5) for each role. This provides the ESO with a clear ex-ante expectation of our assessment of plan delivery if these deliverables are met. Where we considered the delivery schedule not sufficiently ambitious, we highlighted this to set a clear reference point and align expectations in the incentive process. RIIO-2 Final Determinations, Appendix 1, Ibid.
[5] Ofgem's call for evidence 2021-23: https://www.ofgem.gov.uk/publications/six-month-call-evidence-2021-23
[6] The ESO's six-month report 2021-23: https://www.nationalgrideso.com/document/215871/download

year financial incentive outcome.[7] We followed the process described in Chapter 4 of the ESORI guidance document[8] to translate the scores into a projected financial incentive outcome.

For the avoidance of doubt, <u>the scores, and the projected financial outcome we describe below do not automatically equate to an incentive reward or penalty at this stage.</u> Neither are the scores, or projected financial outcome banked for the future. These scores and the projected financial outcome are indicative and are based on the information available to us at the time. They are to inform the ESO on the areas where it is performing well and the areas where improvements need to be made over the remainder of the business plan and incentive period. This will help the ESO to forecast its financial performance and will minimise the scope for misaligned expectations. The final decision on the ESO's scores and financial outcome will be made by Ofgem by 31 August 2023.[9]

**The evaluation criteria**

In determining a score for each role (except for Role 3 where performance metrics are not applicable), we used the evaluation criteria below to evaluate the ESO's performance:

a) Plan delivery
b) Metric performance
c) Stakeholder evidence
d) Demonstration of plan benefits
e) Value for money

**Scoring**

For each of the three roles, we provided scores for the ESO on a scale of 1 to 5, where:

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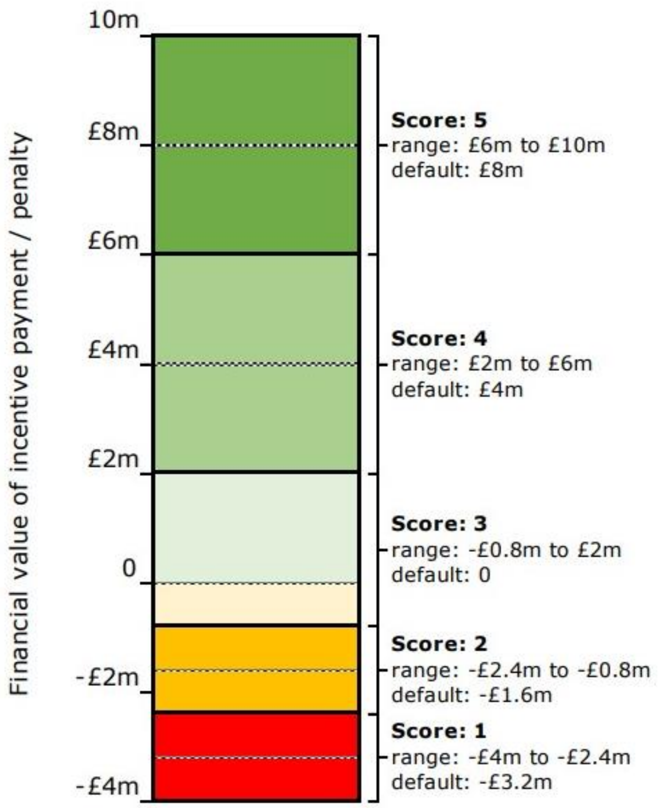
|---|---|
| 1 | Overall performance clearly does not meet performance expectations, for example the ESO has strongly underperformed most criteria |
| 2 | Mixed overall performance and on balance the ESO mostly did not meet expectations, for example the ESO has net underperformance across the criteria |

[7] Paragraph 2.35, RIIO-2 Final Determinations – ESO Annex: "we have also decided to communicate to the ESO what we expect its projected two-year financial incentive outcome will be, every six months, rather than waiting until the end of the scheme. This will help the ESO to forecast its financial performance and will minimise the scope for misaligned expectations." Ibid.
[8] Chapter 4, ESORI guidance document 2021-23: Ibid.
[9] Paragraph 2.31, ESORI guidance document 2021-23: "The Authority will produce its final decision on the incentive reward or penalty by 31 August in the year after the business plan cycle, or such later date that it considers appropriate." Ibid.

| | |
|---|---|
| 3 | Mixed overall performance and on balance the ESO mostly met expectations, for example underperformance and outperformance across the criteria balance each other out |
| 4 | Mixed overall performance and on balance the ESO mostly exceeded expectations, for example the ESO has net outperformance across the criteria |
| 5 | Overall performance clearly exceeds performance expectations, for example the ESO has strongly outperformed most criteria |

In some instances, we wanted to reflect more detail in the scores. For example, a score of 3 denotes that the ESO is meeting 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'. Alternatively, a 'low 3' score signals performance that was slightly below expectations but not considered to be a 2.[10]

**Projected financial outcome**




The maximum reward the ESO can achieve for BP1 is £30m and the maximum penalty is -£12m over two years. These figures are the total incentives value across BP1. As a default, this will be split equally among each of the three roles (+£10m upside and -£4m downside per role).

Each score corresponds to a pre-defined financial default amount and range, as shown in Figure 1.

*Figure 1: financial value of incentive payment / penalty*

[10] Paragraph 3.31, ESORI guidance document 2021-23: Ibid.

## Ofgem's Six-Month Assessment of ESO performance

### Summary

In our RIIO-2 Final Determination,[11] we said the ESO's 2021-23 business plan (BP1) was broadly ambitious and challenging, and that full and good quality delivery would exceed our expectations. At this first six-month review point, the ESO has met our expectations on Role 1 and Role 2 and has marginally exceeded our expectations on Role 3. Whilst the ESO is working toward an ambitious plan, performance over the first six months has fallen short of exceeding our expectations. This is due to notable early delays with milestones associated with major IT projects and market reforms that are anticipated to deliver the most consumer benefit and are crucial to net zero operation of the system. Alongside this we're starting to see internal costs increase significantly above the previously agreed cost benchmark, particularly with several IT projects,[12] with limited robust justification for this. The ESO is only six months into a 2-year plan and it still has the potential to exceed expectations (in line with our Final Determination assessment) if it can respond to our feedback, keep overall delivery on track with its original plan and improve economic efficiency of its market reforms to deliver value for money.

We have summarised our scores, following our assessment of the ESO's performance. In all instances, the scores should be read alongside the detailed feedback.

*Table 1: Summary of ESO's six-month review 2021-23*

| | Role 1 | Role 2 | Role 3 |
|---|---|---|---|
| **Ofgem delivery schedule grading** (Final Determinations) | **5** | **4** | **[low] 4** |
| **Panel recommended score** | [low] 3 | 3 | 3 |
| **Ofgem score** | **3** | **3** | **[low] 4** |
| **Ofgem's projected financial outcome** | **£0m** | **£0m** | **+£2m** |

On Role 1, we awarded a score of 3. Our delivery schedule grading scored the Role 1 plan as exceeding expectations (score of 5). The ESO is working toward an ambitious plan, but performance over the first six months has fallen short of exceeding our expectations. Whilst

[11] Annex 1 (Grading of ESO's Delivery Schedule), RIIO-2 Final Determinations – ESO Annex: https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_eso_annex_revised.pdf
[12] This cost increase is significantly above the previously agreed cost benchmark. The agreed benchmark in our Final Determination was ~£504m for the 2-year period, the ESO's forecast outturn spend for the 2 years is now ~£568m, a ~12.5% increase in the first six months.

the ESO's RIIO-2 plan for this role is very ambitious, delivery has slipped in several instances, particularly on some key IT projects that are foundational to delivering significant consumer benefit. Costs have also increased by ~21% on this role, mainly in relation to these IT projects, with limited justification for this cost increase and limited explanation for how the additional costs will deliver additional benefit.[13] These were the two main areas of underperformance that pulled the ESO down in terms of scoring. The ESO's balancing costs were also high over this period, but we recognise that several external factors beyond the ESO's direct control contribute to these high costs. Stakeholder feedback indicated that the ESO continued to meet expectations. As a result, we considered the ESO to be meeting expectations against its ambitious plan. The ESO could expect to receive £0m incentive reward based on its current projected performance, which is the default financial amount for a score of 3.

On Role 2, we awarded a score of 3. Our delivery schedule grading scored the Role 2 plan as mostly exceeding expectations (score of 4). Whilst the ESO's delivery has been largely on time, some important milestones were delayed. We needed stronger reassurance that overall delivery of key reforms would still be met by the end of the BP1 period, despite early indication of delays. Our evidence also suggests that the quality of the ESO's deliverables so far could have been better (to deliver greater economic efficiency), and its internal costs have started to increase, again closely related to IT delivery (~9% higher than the Role 2 cost benchmark). Overall, we considered the ESO to be meeting expectations and we have outlined several areas of improvement to increase this score back towards the delivery schedule grading. The ESO could expect to receive £0m incentive reward based on its current projected performance, which is the default financial amount for a score of 3.

On Role 3, we awarded a score of a low 4. Our delivery schedule grading scored the Role 3 plan as marginally ambitious (score of low 4), and we said it required a more comprehensive and ambitious plan for the ESO's role in shaping the future network to underpin strategic investment. At present, the ESO's planning and network development activities are marginally exceeding expectations, in line with our delivery schedule grading. The ESO's deliverables and costs appear to be on track. Within this, we recognised that the ESO is working with Ofgem and BEIS to input into wider work beyond its original business plan. Stakeholder feedback met our expectations. The quality of some of the delivered

[13] A large portion of the increase is driven by four IT projects which together were originally forecast to cost £28.1m and are now being forecast to cost £72.7m.

outputs were lower than expected in some places which may reduce the potential benefits of this work, and there were some early warning signs of delays. The ESO could expect to receive a £2m incentive reward based on its current projected performance, which is at the bottom end of the financial range for a score of 4.

## Detailed feedback

### Role 1: Control Centre operations

*Our expectations*

This role requires the ESO balance the National Electricity Transmission System (NETS) in a safe, reliable, and efficient way. This includes contracting and trading with energy market participants as well as working with network owners to optimise physical networks configurations. Other key functions under this role include coordinating with network operators on outage plans and network planning, short term energy forecasting, restoration and emergency response as well as managing and sharing system data and information.

| | |
|---|---|
| **Role 1 score** | 3 |
| **Projected financial outcome** | **£0m** |

*Our six-month assessment*

We agreed with the Panel  and consider the ESO's performance over the first six months is reflective of a score of 3. Our score is influenced significantly by the original level of ambition of the Delivery Schedule, then taking account of some early issues around plan delivery, performance metrics and value for money, which are described further below. The ESO could expect to receive £0m incentive reward based on its current projected performance, which is the default financial amount for a score of 3.

*Plan delivery*

Our delivery schedule grading scored the Role 1 plan as exceeding expectations (score of 5). We recognise that the ESO stated that it is on track to meet many of its deliverables, but we noted that some important milestones were delayed, which shifted our assessment of plan delivery down to meeting expectations, but it is closer to exceeding our expectations than falling below them. If the ESO can address these delays and give us confidence that the IT and training deliverables can be set back on track, they could be "exceeding expectations" by the mid scheme stage.

The ESO has avoided any major incidents that risked system security and progressed the majority of its System Operation deliverables on time, with some elements even being slightly ahead of the ESO's ambitious plan. However key IT delivery in this activity has been delayed (e.g., State of Energy signal Phase 1 data management scoping for the Data Analytics Platform, Enhanced Balancing Capability and Development of inertia monitoring capabilities). Whilst overall delivery was still noted by the ESO as being on track, we would like stronger reassurance that overall delivery of key IT reforms would still be met by the end of the BP1 period, given early indications of delays. There were also delays to the ESO's Control Centre Training deliverables. Whilst we understand COVID-19 has impacted opportunities for in-person training, we believe the ESO could have sought ways to adapt to these circumstances and progress these deliverables. We noted a few delays to the Restoration delivery plan (mainly outside of the ESO's control) but the ESO is currently on track to deliver all key documentation within the set timeframes following the decisions from Ofgem and BEIS. In the round, we consider that good progress is being made in this activity. The ESO is also on track to successfully deliver the key components for Transparency and Data showing strong performance on this activity so far.

*Demonstration of plan benefits*

At this early stage of the two-year scheme, our assessment has mainly focussed on whether the ESO is on track to meet interim milestones that will eventually deliver benefits. There are significant benefits associated with the ESO's IT reforms to deliver its control centre architecture and systems. Given that there are delays in some of these areas (noted above), we have concerns that the benefits will also be delayed. We have similar concerns with the ESO's control centre training and simulation deliverable. As the ESO is on track with most of its Restoration activities, Data and Transparency activities and Transform Network Control deliverables, we also expect it to achieve a substantial portion of these expected benefits. We would like further information on the changes made to the balancing programme and how this will lead to additional consumer benefit.

Overall, the ESO is currently meeting our expectations on the demonstration of plan benefits, but it is closer to exceeding them than falling below them. If the ESO can address these delays and give us confidence that the IT and training deliverables can be set back on track and deliver the benefits in the original timescales, they could exceed expectations by the mid-scheme stage.

*Stakeholder feedback*

We agree with the Panel's conclusions on stakeholder feedback for Role 1 and consider that the ESO has met expectations on this criterion. The ESO had some positive and some negative feedback but the feedback from the ESO's stakeholder survey was predominantly "meeting expectations" (70% of respondents selected this category). Some of the feedback recognised the improvements in the ESO's transparency and data provision. To exceed expectations stakeholders felt that the ESO should, amongst other things, improve communications and provide greater clarity on outage planning/notifications, provide greater transparency regarding management of constraints, and prioritise the efficient dispatch of assets of all sizes.

*Performance metrics*

The ESO had mixed performance regarding the Role 1 metrics. Wind forecasting performance exceeded expectations with consistent good performance throughout the first six months (Metric 1C). Short notice changes to planned outages met expectations with fluctuating performance across the months (Metric 1D). Demand forecasting performance was just below expectations with varying performance across the months (Metric 1B). Balancing costs (Metric 1A) were significantly higher than the benchmark for all months, however we note that wholesale costs and offer prices in the Balancing Mechanism (BM) are markedly higher this year when compared to the years that set the benchmark. We note that the implementation of Phase 1 of the Frequency Response and Control Risk Report appears to have produced a positive impact on balancing costs. As a result, we have taken a more positive view than the Panel regarding balancing costs at this stage. Overall, we consider the ESO's performance against the metrics to be meeting expectations, but it is closer to falling below them than exceeding them. We also agree with the Panel that the ESO needs to show how it has considered more steps beyond their business-as-usual actions to actively address high balancing costs in order to continue to meet expectations going forward.

*Value for money*

We agree with the Panel that the ESO is below expectations on value for money. The ESO's Role 1 costs are forecast to be 21% above the Role 1 benchmark. The ESO's original forecast costs for four IT projects of £28.1m are now estimated to become £72.7m. The ESO has not presented sufficient detail or evidence regarding the cause of this cost increase, how it has been estimated and how the additional costs represent value for money (i.e., through delivering additional consumer benefit).

*Going forward*

Overall, we recognise the ESO's ambitious plan for Role 1. The ESO should seek to address the delays in delivery to ensure that it can deliver the benefits set out in its plan and explore all available options to address the increased balancing costs. We also expect to see cost controls or other significantly stronger evidence to demonstrate that the ESO is still delivering value for money in light of the projected overspend against the Role 1 benchmark.

We also encourage the ESO to take on board the feedback we provided in our Delivery Schedule grading for Role 1. To ensure that it exceeds our expectations, the ESO could:

- ensure that the data platform is designed in a way that interoperates with the energy data ecosystem and beyond, and take steps to demonstrate that it is treating its data processing methods and algorithms as presumed open
- ensure that it delivers upon the commitments outlined in its Energy Forecasting Roadmap, in addition to the commitments outlined in its updated Delivery Schedule.

**Role 2: Market development and transactions**

*Our expectations*

This role requires the ESO to operate the balancing mechanism and develop and procure a number of additional balancing services to balance and operate the system in a safe, reliable and efficient way. The ESO administers and is party to various codes[14] and is able to propose changes to these codes, provide its expertise and analysis to aid industry discussions, and influence the final recommendations that go to the Authority. It is also the Electricity Market Reform (EMR) delivery body and has transmission system operator (TSO) responsibilities related to implementing European network codes and regulations.

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| **Role 2 score** | 3 |
| **Projected financial outcome** | £0m |

*Our six-month assessment*

We agreed with the Panel and consider the ESO's performance over the first six months is reflective of a score of 3. The ESO could expect to receive a £0m incentive reward based on its current projected performance, which is the default financial amount for a score of 3.

*Plan delivery, stakeholder feedback and demonstration of benefits*

[14] The ESO administers the Connection and Use of System Code (CUSC), the Grid Code, the SO-TO code (STC) and the Security and Quality of Supply Standard (SQSS). The ESO is party to the Balancing and Settlement Code (BSC) and the Distribution Code.

The ESO is on track, or close to being on track, with plan delivery.[15] Stakeholder feedback and the ESO's demonstration of plan benefits have been mixed, but overall, we think the ESO is meeting expectations on each. We have commented on each criterion in relation to the Role 2 activities below.

- *Reform of balancing and ancillary services (A4)*

In previous incentive years, the Panel, stakeholders and Ofgem have highlighted the importance of delivering tangible new markets and product developments. In line with this feedback, the ESO developed a plan that we considered ambitious for its proposals for reforms such as co-optimised reserve and response auctions and a single platform for all markets. The ESO has made progress against the milestones of this plan, and its delivery and further refinement of the ESO's new Dynamic Containment products were welcome. However, we note that these milestones were delayed, and we are now seeing indications that future product launches are likely to be delayed as well. Additionally, we have seen some issues with the design of auctions leading to reduced economic efficiency, alongside mixed stakeholder feedback. As a result, we currently consider that the ESO is falling slightly short of its original proposals, and that this area of work is meeting our expectations for plan delivery, stakeholder satisfaction, and demonstration of plan benefits.

However, we acknowledge that the ESO has not indicated that early current delays/issues with product launches will lead to a delay to the launch of the single market platform for response and reserve. If the ESO can take corrective action to get back on track with its plan and maximise the consumer welfare / economic efficiency of its products, then it could still exceed our expectations at the end of BP1.

- *EMR (A5)*

The ESO has been regularly engaging with stakeholders on its new EMR portal and its engagement has been praised. However, the legacy EMR portal has not met the expectations of participants, with stakeholders expressing concerns about the portal being cumbersome and sometimes unusable. We also note that there have been issues relating to licence breaches or CM Rules breaches and that some still need to be addressed. Therefore,

[15] We note that the ESO had previously planned milestones relating to project TERRE and MARI and we acknowledge that these will no longer be possible due to the trading arrangements in place between the UK and EU. As a result, we will not be assessing the ESO's progress against these deliverables. However, the ESO does have new obligations that stem from the requirements in the UK/EU Trade and Cooperation Agreement ("TCA"). We understand that it is making steady progress against these new requirements.

on balance we consider that this area is currently meeting expectations for plan delivery, stakeholder satisfaction, and demonstration of plan benefits.

Going forward, if the ESO can address issues with the existing portal (for example, through providing better support and assistance for users of the portal), showing step change improvement in user experience and deliver the new portal in a collaborative manner, it could exceed our expectations by the end of BP1.

- *Industry codes and charging (A6)*

The deliverables associated with industry codes have been completed in line with the ESO's delivery schedule. Overall stakeholder satisfaction for the ESO's code administration is now on par with other code administrators, which is a positive improvement compared to previous years.

The ESO's charging deliverables are also on track with the ESO stating it has completed improvements to the current charging and billing system to ensure its reliability until the new system is in place. However, in April, the ESO informed industry of a notable problem in the charging methodology for sites that connect to a GSP used by more than one DNO. In this instance we believe that the ESO acted slowly to resolve this issue, which could lead to a sub-standard arrangement for the next TNUoS charging cycle.

On balance we consider that this area is currently being performed in line with its delivery schedule and is meeting expectations for plan delivery, stakeholder feedback and demonstration of benefits.

*Performance metrics*

There is one metric for Role 2 (Metric 2A: Competitive Procurement). The ESO is meeting expectations with 59% of its services being procured through competitive means (calculated by expenditure). Using absolute values, the ESO would have competitively procured 51% by competitive means and thus would still be meeting expectations.

*Value for money*

The ESO is 9% above its cost benchmark for Role 2. The Settlements and Charging and Billing Replacement projects have increased from a combined £6.8m to £15.2m. Conceptually, we can appreciate that a single platform may be more operationally efficient, but the ESO has not explicitly explained what this joint system will be able to do that the two separate systems would not. We also understand that the ESO intends to spend an additional £6.8m on the legacy EMR system over two years, and that this is driven by regulatory changes for the Capacity Market and Contracts for Difference. This is broadly in line with annual CAPEX spend during RIIO-1. We also understand that the ESO had originally intended to spend £3.5m on the new EMR portal, but this investment now requires an additional £3m in RIIO-2. It is not clear why this cost was not included in the cost benchmark for BP1.

Without additional justification, we consider that the ESO is meeting expectations for this criterion. Nevertheless, if the ESO can better explain the additional functionality that the joint Settlements and Charging and Billing Replacement project will offer, and demonstrate the delivery of additional beneficial outputs, it could overperform this criterion.

*Going forward*

In addition to addressing the points raised in our assessment above, we re-encourage the ESO to take on board the feedback we provided in our Delivery Schedule grading for Role 2. To ensure that it exceeds our expectations, the ESO could:

- Ensure that it uses lessons learned from pathfinders to demonstrate clear progress in implementing enduring markets for solutions to stability, voltage and thermal constraints.
- Develop plans for coordinated, competitive markets that cover all system services and align with distribution-level flexibility markets. It could also work with DNOs to ensure that service providers have a single, consistent set of procurement requirements when looking to provide services to the ESO or DNOs.
- Demonstrate how it is proactively shaping wider market arrangements (such as balancing, wholesale and capacity markets) and industry frameworks, particularly when it comes to the development of distribution-level operational frameworks.
- The ESO could also go further than just ensuring compliance with EU regulations, and bring together GB stakeholders to develop and implement strategic plans for ensuring efficient trading relationships with connected TSOs.

**Role 3: System insight, planning and network development**

*Our expectations*

The ESO is responsible for publishing key insight documents on credible long-term pathways for the energy sector and on long-term electricity system needs. It also produces the annual Network Options Assessment (NOA), wider NOA methodologies and looks into long-term operability solutions via its NOA pathfinding projects. The ESO coordinates offshore network development and works with DNOs to ensure that its efficient and coordinated network development activities maximise whole system benefits across network boundaries. The ESO is also responsible for the connections process to use the electricity transmission system and for managing the impacts on the NETS from new connections of new offshore generation as well as at distribution level.

| | |
|---|---|
| **Role 3 score** | [low] 4 |
| **Projected financial outcome** | **£2m** |

*Our six-month assessment*

Overall, we consider the ESO is on track for a low 4. We agree with the majority of the Panel's conclusions and messages for Role 3. However, we consider the ESO is on track for a slightly higher score than the Panel's recommendation. We are more confident that the ESO is on track to deliver its business plan and therefore most of its expected future benefits. We have also reached a marginally more positive assessment on value for money.

The ESO could expect to receive a £2m incentive reward based on its current projected performance, which is at the bottom end of the financial range for a score of 4. This assessment is informed by our consideration of the original level of ambition of the Delivery Schedule, and some issues around stakeholder feedback and demonstration of benefits, which are described further below.

*Plan delivery*

The ESO appears broadly on track to deliver the key components of its business plan. The ESO has therefore exceeded our expectations on plan delivery considering the original ambition of the plan. However, there are some early signs of delays to planned improvements to network assessment tools and processes. We will be monitoring this area closely and encourage the ESO ensure it is getting sufficient attention. We agree with the Panel that it's important that the ESO has both the resource and capability to deliver its business plan's aims alongside the additional outputs expected under wider network planning reviews (such as the Offshore Transmission Network Planning Review (OTNPR) and Electricity Transmission Network Planning Review (ETNPR)). We encourage the ESO to be transparent about its ability to deliver these outputs concurrently and whether there are any consequences that arise from these new developments that may merit changes to the original business plan.

*Demonstration of plan benefits*

As the ESO is on track with most of its deliverables, we also expect it to achieve a substantial portion of its expected benefits. The pathfinders are an area where we expect the ESO to deliver significant additional value for consumers, therefore delivering those benefits on time and in full will be key. There are some areas where the ESO could have delivered higher quality outputs to support its demonstration of benefits. This includes running a more streamlined process for Stability Pathfinder Phase 2 and showing us more tangible examples of specific actions taken since April 2021 on the Regional Development Plans. The ESO’s evidence on diversity in the Network Options Assessment suggests more progress also needs to be made to enable more types of provider to offer solutions to thermal constraints. Linked to this, we would like to see more evident progress with the ESO’s five-point plan for constraints, to realise the significant potential consumer benefits at stake. Overall, the ESO is currently meeting our expectations on demonstration of benefits, but it is closer to exceeding them than falling below them.

*Stakeholder feedback*

We agree with the Panel ’s conclusions on stakeholder feedback. We note that Role 3 had the greatest number of stakeholders deeming that the ESO is below expectations (24%), and that much of this was attributed to the pathfinder process. We recognise that when challenging the status quo, it is not possible to receive strong support from all parties. Nevertheless, this feedback has continued from past schemes. Whilst it is coming from a range of parties, we did note that a large proportion was from TOs. We are encouraged by the work the ESO has undertaken with stakeholders to improve the pathfinder process for Stability Phase 3, but we think the ESO could build on this to provide more confidence to stakeholders on the pathfinder process. The ESO is currently meeting our expectations on stakeholder feedback but is closer to falling below them than exceeding them. We hope to see improved feedback at the next review point.

*Value for money*

The ESO is currently exceeding our expectations on value for money. This is because its spending is broadly in line with the Role 3 cost benchmark, it is on track for most of its deliverables and it is also delivering additional outputs on the ONTPR and Early Competition.

*Going forward*

In addition to addressing the points raised in our assessment above, we re-encourage the ESO to respond to the feedback we provided in our Delivery Schedule grading for Role 3. For the ESO to score more highly by the end of the scheme, we would expect to see:

- The development of a clear future vision and strategy for an optimal network assessment process (or suite of integrated and harmonised processes) capable of addressing zero-carbon system operability challenges. This would more clearly explain how the NOA (or any replacements to the NOA), RDPs, pathfinders, and

future enduring markets to fit together and deliver the aim of facilitating a level playing field for all types of solutions to compete to solve all types of network needs.
- The ESO using the learning from pathfinders to implement a detailed plan for regular, dependable markets for solutions to system issues.
- More details on what the ESO will cover through its deeper whole system insights, as well as more specific recommendations on how existing frameworks need to be aligned to deliver whole system outcomes.
- More information on how the ESO will deliver step change improvement to existing connections process versus RIIO-1. This includes more details on the functionality of the proposed connections platform, including the extent it will align or integrate with TO and DNO systems.

We recognise that network planning is a fast-evolving area and there have been several developments since the RIIO-2 Final Determinations. This includes further progress on Early Competition and the OTNPR (including the ESO taking on responsibility for a Holistic Network Design), as well as Ofgem launching the ETNPR.[16] The ESO has a key role in these projects, and we believe they present a good opportunity for it to further demonstrate the expectations we have set out above and in our ESO Roles Guidance. We would like to see the ESO thinking more holistically, proactively drawing links between the different workstreams and presenting a consolidated view on the best overall future arrangements for network planning.

[16] Electricity Transmission Network Planning Review: https://www.ofgem.gov.uk/publications/consultation-initial-findings-our-electricity-transmission-network-planning-review

## Cost benchmark update

The ESO's cost benchmark was set at £504.1m as part of the Final Determinations process.[17] We said that we would consider adjusting the benchmark on a bi-annual basis, alongside the ESO's six-month review. We also said that we would reassess the remaining £3.6m of uncertain capex and £6.1m of other price control costs, when we consider sufficient information has been provided by the ESO.[18] The £3.6m of uncertain capex relates to ENCC Capex (£2.0m) and Project TERRE (£1.6m), and the £6.1m relates to cyber security costs.

We have made the following updates to the cost benchmark:

1. In the ESO's six-month report, the ESO added £2.0m to the cost benchmark to include costs relating to upgrades and enhancements to the ENCC.[19] This investment was originally not included in the cost benchmark for Role 1 as the project was incorrectly categorised as an IT&T investment. We agree that this expenditure should be added to the Role 1 cost benchmark.
2. The ESO's six-month report also reallocated expenditure on the Digital Engagement Platform investment to Role 1. This investment was originally split equally between all three roles in our Final Determinations. We agree that this expenditure should be fully allocated to the Role 1 cost benchmark.
3. We have identified a rounding error in the original cost benchmarks set in our Final Determinations. This error arose from the exclusion of Project TERRE costs from the Role 2 cost benchmark. The Role 2 benchmark should have originally been set at £160.0m rather than £160.1m. We are correcting this error as part of this cost benchmark update.

We note that the Project TERRE investment is no longer anticipated in the near future and this expenditure is not expected to be included in the 2021-23 cost benchmarks.

The updated cost benchmarks are set out in Table 2 below. The ESO should refer to this updated cost benchmark in all future reporting, unless otherwise stated.

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[17] Page 50, Final Determinations – ESO Annex: https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator
[18] Page 55, Final Determinations – ESO Annex: Ibid.
[19] Page 168, ESO Mid-Year 2021-22 Evidence Chapters: https://www.nationalgrideso.com/our-strategy/riio/how-were-performing-under-riio-2

*Table 2: Updated ESO cost benchmarks*

| | Role 1 | Role 2 | Role 3 | Total |
|---|---|---|---|---|
| Cost benchmarks in RIIO-2 Final Determinations (February 2021) | £203.2m | £160.1m | £140.8m | £504.1m |
| Updated cost benchmarks (December 2021) | £208.0m | £158.6m | £139.4m | £506.0m |

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