

Report

ESO Performance Panel Six-Month Review 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 as the Secretariat for the ESO Performance Panel, detailing the Panel's assessment of the ESO's performance at the six-month review stage.

This report contains the views of the Panel, not Ofgem.

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RIIO-2 ESO Incentive Framework

Background

In April 2021, Ofgem introduced the new RIIO-2 price control for the ESO (covering the period between 2021-26).¹ The price control consists of a pass-through funding approach, supported by performance-based financial incentives to deliver value for money. The incentives framework runs over a two-year period (aligning with the business plan period²) and is underpinned by the ESO Roles Guidance that sets out Ofgem’s expectations for the ESO’s activities and outcomes.³ The ESO’s combined performance on outputs and costs will be evaluated, across the full spectrum of its roles. 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. It assesses the ESO’s performance every 6 months, identifying areas where the ESO are performing in line with expectations, where it is exceeding expectations and where it is not meeting expectations. This gives the ESO early feedback on its performance and the opportunity to act on this and make any necessary improvements during the remaining months of the scheme. For RIIO-2, we appointed an independent (non-Ofgem) Panel chair to lead the ESO Performance Panel.⁴

Approach

This six-month review covers the first six months of the Business Plan period (BP1) from April 2021 to September 2021. The ESO published its six-month report on 25 October 2021.⁵ The Panel convened on 18 November 2021 to assess the ESO’s performance. The Panel followed the process described in Chapter 3 of the ESORI (Electricity System Operator Reporting and Incentive Arrangements) guidance document⁶ 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).⁷ The Panel assessed the evidence provided by stakeholders⁸, the ESO and collected by Ofgem throughout the first six months and used

¹ RIIO-2 Final Determinations: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

² The ESO’s business plan period, otherwise referred to as BP1, runs from 2021-23.

³ ESO roles and principles 2021-23:

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

⁴ Appointment of independent Panel chair: <https://www.ofgem.gov.uk/publications/appointment-independent-panel-chair-0>

⁵ ESO six-month report 2021-23: <https://www.nationalgrideso.com/document/215871/download>

⁶ [ESORI Guidance Document 2021-2023 \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/esori-guidance-document-2021-2023)

⁷ RIIO-2 Final Determinations: Ibid.

⁸ Ofgem six-month call for evidence 2021-23: <https://www.ofgem.gov.uk/publications/six-month-call-evidence-2021-23>

the evaluation criteria below to provide scores for each of the ESO’s roles. **These scores are indicative and do not equate to an incentive reward or penalty at this stage.** The Panel’s feedback is used to inform Ofgem’s assessment of ESO performance, which will also be carried out every six months. This process provides the ESO with regular feedback which it may use to shape its performance and does not lock in or ‘bank’ any outcome. The final decision on the value of ESO’s financial incentive outcome for the BP1 period (2021-23) will be made by Ofgem by 31 August 2023⁹.

The evaluation criteria

In determining a score for each role (except for Role 3 where performance metrics are not applicable), the Panel 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 role, the Panel provided scores for the ESO on a scale of 1 to 5, where:

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
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

⁹ National Grid Electricity System Operator Limited Electricity transmission licence: [Special Conditions - ESO \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/special-conditions-eso)

Summary of ESO Performance Panel's assessment

Overarching message

The Panel welcomed the information provided by the ESO in its first RII02 six-month report.

Overall, the Panel reflected that the ESO's Business Plan delivery must adapt to address current and emerging system priorities and additional responsibilities in some areas. Given conflicting pressures on resource and changing demands, it was not always clear how the ESO's priorities are being set and its resources deployed to maximise consumer benefit, particularly between delivery of the Business plan and new changes/policies originating from BEIS, Ofgem or the market. The Panel would like the ESO to better emphasise the key priorities for each role as this would support the Panel to fairly assess overall performance. The Panel encouraged the ESO to provide evidence of the prioritisation process, explaining how/why projects have been prioritised, especially if those priorities change during the two years. The Panel noted that the ESO is continuing to build its resource and capabilities and they expect this resource to be prioritised into the right areas to have the biggest impact on performance for customers. It is anticipated that the benefits of the additional resource will feed through into plan delivery through the BP1 period.

The Panel reflected that the majority of the ESO's deliverables and consumer benefit are expected to materialise toward the end of the two-year BP1 period. At this early stage of the two-year scheme, there was relatively sparse evidence to assess in relation to consumer benefit, so they found it difficult to comment on the ESO's delivery of plan benefits. The Panel also noted that, whilst some delivery milestones were clearly delayed, overall delivery was still noted by the ESO as being on track. The Panel requested stronger evidence that the overall delivery of key reforms would be achieved by the end of the BP1 period, despite some early indication of delays.

The Panel also reflected that major IT programmes are central to successful delivery in BP1, and these have already seen a notable increase in costs, particularly on Role 1, raising concerns about delivery and value for money. The Panel recognised that cost/scope creep is a key risk with all IT programmes and that this requires careful management. More justification is required from the ESO that IT project cost and scope is being effectively managed.

Overall, the scores the Panel gave reflect that the ESO was meeting, or close to meeting, expectations. This assessment reflected the fact that the ESO's Business Plan is generally

ambitious and would exceed expectations if fully and well delivered, but as far as can be assessed at this early stage the ESO is behind on some milestones (contributing to some poor stakeholder feedback) and overrunning on some IT costs. The Panel noted that as progress is made through the two-year scheme, there is significant potential for the ESO to exceed expectations and receive higher scores through the economic, timely and high-quality delivery of its planned deliverables.

The Panel also recognised the difficult landscape the ESO was currently operating in and wanted to encourage the ESO to consider the wider role it could play within the electricity sector. For example, by considering developments in the wider energy market, including the decline of smaller players, and the potential impact this has on balancing, settlement, and system operations and whether there are market interventions the ESO could spearhead.

Summary of scores

We have summarised the scores agreed by the Panel, following its assessment of the ESO’s performance. In some instances, the Panel wanted to reflect more detail in their 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, overall, 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.

In all instances, the scores should be read alongside the detailed feedback. This report captures the breadth of views that were expressed, and the reasoning provided by the Panel members.

	Role 1	Role 2	Role 3
Panel score	[Low] 3	3	3

Role 1: Control Centre operations

This role requires the ESO to 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	[Low] 3
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The Panel agreed on a score of 3 and reflected that the ESO was within the lower range of this score. The Panel reflected that this role showed the biggest difference from Ofgem's delivery schedule grading (score of 5).

- Overall, the Panel was concerned that there was minimal evidence of the ESO considering proactive actions to tackle high balancing costs. In particular, there is insufficient confidence that the ESO is prioritising addressing the causes of very high balancing costs, and the impact of high costs on the wider market. In addition, internal costs were increasing significantly above the cost benchmark, and there was limited progress on important elements of plan delivery. These were counterbalanced by some areas of good performance, for example on progressing measures to reduce constraint costs.
- The Panel expressed concern over the system disturbance events in Scotland over this regulatory period and there was some concern about system operability going forward over the Winter months, especially with tighter margins.
- On plan delivery, the Panel noted that only 25 of 47 milestones were met. They recognised the ESO's ambitious plan and agile way of working but would like the ESO's priorities clearly set out and justified. The Panel wanted more confidence that overall delivery won't be affected by these early delays. The Panel were also concerned that missed milestones at this stage may cause a delay in the realisation of benefits. The Panel did note the positive progress on Distributed Restart and the Frequency Risk and Control Report which resulted in RoCoF costs decreasing.
- The Panel were particularly concerned by the significant increase in Role 1 costs, which were ~21% higher than the agreed cost benchmark. The Panel did not think this cost overrun had been adequately explained. The Panel was concerned that this represented poor value for money and reflected that Ofgem's high delivery schedule grading for this role was largely based on the delivery of significant IT projects. The Panel expect the ESO to provide clear justification and careful management of these costs going forward, reflecting on past experience.
- The Panel noted positive stakeholder feedback on transparency and industry engagement with 72% of stakeholders ranking the ESO as meeting expectations. There was particularly positive feedback on Distributed Restart and the

Operational Transparency Forum, but some opportunity to improve industry engagement on the new Electricity System Restoration Standard.

- The Panel reflected that there was mixed performance with the metrics overall. Wind forecasting was exceeding expectations (Metric 1B), but balancing costs (Metric 1A) were very high and below expectations. While some aspects of the high balancing costs were outside of the ESO’s control, the Panel thought the ESO could have taken – or showed consideration of taking – more proactive action to drive these balancing costs down (similar to how the ESO took actions to address high operability costs during the early period of Covid-19 lockdown).
- To improve the Role 1 score at the next review point, the Panel would like to see plan delivery back on track (with a clear indication of the ESO’s priorities) and a stronger focus on justifying and managing the value for money of Role 1 activities in light of the large cost increase.

Role 2: Market development and transactions

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 codes¹⁰ 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.

Role 2 score	3
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The Panel agreed on a score of 3.

- Overall, similar to Role 1, the Panel considered that there was little evidence that the ESO was considering market design options to address high balancing costs and there were concerns about the quality of some plan deliverables. However, the Panel welcomed the work that was underway on future Net Zero market design. The Panel thought there was some work to do to be in line with Ofgem’s original delivery schedule grading (score of 4).

¹⁰ 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.

- On plan delivery, the Panel noted that the ESO met most milestones within the first six months (17 out of 22 milestones) but noticed that delays were starting to appear in some areas (e.g., reserve reform, in particular the Quick Reserve product, with little communication from ESO around revised timelines). There was also mixed feedback on the quality of the ESO's deliverables, specifically related to design issues with the Dynamic Containment and STOR products. The Panel encouraged the ESO to learn from and apply these lessons going forward to avoid repeating the same mistakes for other products. The Panel also wanted more reassurance that the major two-year deliverables in this area (e.g., Single Markets Platform) were still on track despite some early milestones slipping.
- The Panel recognised that the ESO's stakeholder feedback continued to improve from last year. Whilst the ESO's engagement is good overall, it was noted that during this six-month period stakeholders again flagged a lack of transparency and explanation regarding some of the ESO's decision making.
- The Panel also recognised continued dissatisfaction with the EMR Portal (e.g., issues with the Capacity Market Prequalification Process), but it was also noted that this is a legacy issue and the ESO is designing a new portal for next year and the process for including stakeholders in this design work has been positive.
- The Panel found it difficult to comment on demonstration of plan benefits at this early stage of the two-year scheme. Panel members recognised that lots of activities appeared to be underway, but they wanted to better understand what the priorities are in order to see a clear focus on the areas that will maximise consumer benefit. The Panel noted the Role 2 costs were ~9% above the cost benchmark in the first six months. The Panel did not think this cost overrun had been adequately explained and they wanted reassurance that this expenditure will not increase further over BP1 (unless overspending clearly leads to over-delivery).
- The Panel considered the metrics performance as in line with expectations.
- Going forward the Panel would like to see the ESO focus on delivering priority outcomes and maximising benefits. In particular, the ESO should show how its Role 2 priorities will contribute towards reducing balancing costs and delivering a net zero electricity system.

Role 3: System insight, planning, and network development

Under this role, the ESO performs a variety of insight, planning, and network development activities. It publishes key insight documents that include credible long-term pathways for the energy sector, and it identifies 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 also 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	3
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The Panel agreed on a score of 3 which reflected that the ESO was reasonably on track with improved clarity on its direction, but at this stage, there was limited evidence of clear outperformance or underperformance to warrant a higher or lower score.

- On plan delivery, the Panel thought the ESO was broadly on track given the number and complexity of projects the ESO is working on that are additional to its original RIIO-2 Business Plan deliverables (e.g., OTNR and Early Competition). The Panel recognised the amount of work involved and welcomed the ESO’s contributions. The Panel encouraged the ESO to ensure it has the extra capabilities required to deliver these technically challenging new outputs, along with the existing Role 3 deliverables (i.e., this shouldn’t be at the expense of the existing Role 3 deliverables). The Panel would like to have more understanding of the ESO’s priorities in this area, to better understand how this additional work is expected to progress going forward.
- The Panel was concerned about whether Pathfinder projects were on track to deliver consumer benefits. Issues were noted with the extent to which experience from the early pathfinders is being taken forward. In particular, in previous years the Panel had given the ESO some leeway on pathfinders to recognise that this work was new/untested, the Panel expect the ESO to now ensure the lessons learned from phase 1 and phase 2 of the Stability Pathfinder are applied to drive forward phase 3. While there was some evidence of the ESO applying past lessons to Stability Pathfinder phase 3, the further delays and uncertainty regarding Stability phase 2 was a key concern.
- The Panel noted limited evidence of progress on the ESO’s 5-point plan for constraints and expected to see significantly more progression on this given the anticipated magnitude of future constraints costs.
- The Panel discussed the mixed performance of the Regional Development Plans but recognised the collaborative nature of these projects (e.g., close interaction with DNOs) and the degree to which performance was not entirely within the ESO’s control.

- The Panel found it difficult to comment on demonstration of plan benefits at this early stage of the two-year scheme but noted that several Role 3 deliverables should deliver consumer benefits in the future if quality and timeliness of these deliverables is achieved. The Panel encouraged the ESO to remain mindful of the bigger picture and wider priorities that cut across the Role 3 activities. For example, in considering and recognising how the use of the NOA and FES could evolve in the near future.
- The Panel recognised that most of the stakeholders' feedback suggested the ESO was meeting expectations, but a notable proportion (e.g., 25% of stakeholders in the survey, the highest proportion for all roles) said the ESO was below expectations. The Panel discussed the negative feedback, mainly related to Stability Pathfinder phase 2 and issues related to the efficiency and timeliness of ESO connections processes. The Panel noted that negative feedback was provided by a variety of parties and Panel members would like to see evidence at the next review point of the ESO responding to and addressing this feedback.
- On Value for money, the Panel noted that Role 3 costs were broadly on track, which was positive considering the extra work that the ESO had committed to.
- Going forward, the Panel expects the ESO to continue at pace to improve capability in this area. The Panel suggested that the ESO should reflect all wider work being undertaken in Role 3 in its next iteration of the business plan for 2023-25 (BP2). The Panel encouraged the ESO to continue to consider future policy changes that may impact Role 3 and consider what consequences these changes could have on what activities are required when.

Annex: RIIO-2 Panel Membership 2021-23

The members of the Panel include:

- Jo Butlin (Panel Chair)
- Ian Tait (independent Panel member)
- John Carnwath (independent Panel member)
- Robert Hull (independent Panel member)
- Energy UK (represented by Iona Penman)
- Association of Decentralised Energy (represented by Chris Kimmet)
- Energy Networks (represented by Lynne Bryceland)
- Citizens Advice (represented by Richard Hall)

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