



Northern Powergrid's response to Ofgem's consultation on the DSO incentive governance document

KEY POINTS

- The proposed document provides a generally effective description of the DSO incentive processes and requirements.
- Our main feedback is that the weighting should be changed to avoid placing 80% of the weighting on more subjective assessments (i.e. the sum weighting of the stakeholder satisfaction survey and performance panel assessment).
 - Other than weighting, the arrangements for these two components look reasonable.
- For the outturn performance metrics, there are some remaining issues to resolve:
 - Ofgem and stakeholders need to recognise that the secondary network visibility outturn metric will take time to 'bed in' and is unlikely to produce a reliable view of DNO performance until a few reporting cycles are completed.
 - The curtailment efficiency metric is seeking to incentivise behaviours that are not supported by Ofgem's Access and Forward-Looking Charges Significant Code Review ("Access SCR") decision and has practical challenges with any new data collection that would require funding and time to roll out.
- We support the proposal to financially incentivise DNOs from the second year of the ED2 period. This mitigates the risk of arbitrary rewards or penalties arising in the period prior to the incentive scheme requirements being finalised and implemented.

1. Introduction

1. We provide our comments below and have structured our feedback according to the main sections of the governance document. We note there are no specific questions in the consultation, and we are offering comments and suggestions.
2. Most of the comments relate to the performance metrics where we consider there is the most work to do and there are some pitfalls to avoid in the approach currently being proposed.
3. By their nature, these are comments by exception that follow extensive dialogue through the working group meetings conducted up to this point. As such, where we are silent Ofgem should assume that we are broadly comfortable with the proposals or are not requesting any changes from Ofgem.
4. We have reviewed the drafting detail of the document and have also provided comments in the issues log provided with this response to the consultation.

Purpose of the document and incentive

5. Para 1.6 of the draft governance document refers to revision “in accordance with Part [A] of Special Condition [1.3]”. To the extent that they apply in this case, we would reiterate the comments we made and the concerns we expressed in our response to the informal licence drafting consultation regarding GEMA’s “self-modification” powers and the Competition and Markets Authority’s (CMA’s) decision on the matter in the transmission and gas distribution appeals.
6. In the event that Ofgem seeks to make changes in the future, for example to introduce a funding mechanism, any such changes should be made to the licence condition such that those changes are subject to the appeal process set out in the Electricity Act 1989.

2. DSO incentive framework

7. Customers benefit from the ability of Ofgem and stakeholders to compare between DNOs. Having one, consistent incentive mechanism across all DNOs naturally means that those making judgements about DNOs’ performance will be making comparisons as opposed to individual assessments. This is a strength of price control reviews as comparative benchmarking enables Ofgem to overcome information asymmetry and make decisions on an objective basis. However, this requires deep scrutiny. The stakeholder survey and performance panel assessments are

unlikely to provide a sufficiently detailed assessment to be objective where delivery of DSO functions is linked to each individual DNO's customer or system requirements. As such it is impossible to say with confidence that the outcome is fully justified.

8. Accordingly, the 80% of weighting attributed to the more subjective judgements as detailed above should be reduced and the weighting of the metrics increased.

3. DSO Stakeholder Satisfaction Survey

9. These arrangements appear reasonable.

4. DSO Performance Panel Assessment

10. In para 4.20, the draft governance document states "The DSO Performance Panel will be asked only to take account of evidence if it relates to 'new' actions taken by the DNO within that Regulatory year." This suggests that the panel's assessment will be a view of relative progress made in the regulatory year against the baseline expectations as opposed to an absolute view of performance. We consider that absolute performance, linked to customer and stakeholder need, is what should be incentivised.
11. It would be useful for Ofgem to clarify whether the assessment is a relative year-to-year review or an absolute view of performance.

5. Outturn Performance Metrics

12. In principle, these are reasonable metrics. However important changes are required in the detail to ensure that the metrics measure the outcomes that are of value for customers and avoid inappropriate or perverse consequences.
13. The metrics have resulted from a significant amount of discussion in working groups in which we have participated. This led to an effective choice of metrics that incentivise DNOs to deliver outcomes that are of value and recognise the state of evolution of the DSO functions.
14. The context of the metrics is that they are being developed and implemented at the same time as some of the processes on which they are intended to report. This contrasts with the metrics in the Electricity System Operator price control where the underlying processes were mature prior to them being included in the regulatory incentive.

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15. We support the proposal in para 5.4 to financially incentivise DNOs from the second year of the ED2 period. This mitigates the risk of arbitrary rewards or penalties arising in the period prior to the incentive scheme requirements being finalised and implemented.
16. It is important that the design of outturn metrics satisfy the following principles:
- a. outcomes that are of value to customers;
 - b. outcomes that are under the control of DNOs to deliver; and
 - c. it is clear what a good outcome entails (e.g. a higher score is a better outcome).
17. Turning to the detail, we have specific comments on each metric.

Flexibility market testing

18. This is a good metric since it meets all three criteria identified above.
19. We support the proposal that investment decisions on the primary network are considered separately to those on the secondary network with this metric applying only to the former. The ability to use flexibility is at different levels of maturity in each area. It is right that the funding for flexibility on the secondary network is being considered separately through development of the load-related expenditure mechanisms. We are supportive of such funding being achieved through either adaptation of the volume driver or with a use-it-or-lose-it mechanism.

Secondary network visibility

20. This metric scores well on the criteria of being of value to customers and clarity on what good looks like but the DNO is only partly able to control it (e.g. the uptake in heat pumps). As such, some of the rewards or penalty arising could be arbitrary and, since the metric is not yet implemented, there is a lack of any data to evaluate this weakness in the proposal. If implemented from April 2023, there needs to be understanding from Ofgem and stakeholders alike that the data may not be reflective of DNO performance in the first years of its operation.
21. There is currently no regulatory requirement for DNOs to forecast transformer utilisation. That said, all DNOs are exploring how to introduce these processes during ED2 since it is consistent with the DSO baselines. However, having this capability in place on or before April 2023 is challenging.
22. Stakeholders would expect that DNOs are all measuring the same parameters and being incentivised in a consistent manner. It is common that when DNOs start to report new data that variations in technique and definition emerge in the first few cycles of operation. These
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differences then need to be normalised for all to be confident that consistent measurement and interpretation of the standard is being followed. Starting the measurement from the start of the ED2 period allows no time for any of this process.

- 23. The offset in monetising the incentive is important in this respect. It allows some time for the implementation to be 'bedded in' prior to the financial element being triggered.
- 24. We support the different treatment of monitored and unmonitored transformers to provide for different levels of accuracy in the forecasting.
- 25. Several of the key factors that may cause a change in utilisation rates between forecast and outturn (EV and heat pump uptake) are outside of the DNOs' control.
- 26. Finally, it is unclear how will this metric interact with the load related uncertainty mechanisms or the totex incentive and it could be that this metric gives rise to a perverse incentive that works against the intentions of the other mechanisms – e.g. oversizing a transformer so that it drops into a different weighting band. There has been little time afforded to considering these interplays between different elements of the price control incentive regime as it comes together in parallel workstreams.

Curtailment efficiency

- 27. This metric should be applied to those customers connected on 'non-firm' connections after making an application from 1 April 2023 i.e. where the customer has been provided with a guaranteed level beyond which they will not be curtailed (in line with Ofgem's Access SCR decision).
- 28. There are two problems with Ofgem's proposal to apply this incentive retrospectively to connections already operational that pre-date implementation of the Access SCR decision:
 - a) Ofgem is undermining its own Access SCR decision where it spent a number of years carefully looking at the various options and determined the issue of retrospective application. This was ruled out after that due process and scrutiny. Ofgem is now over-reaching its Access SCR decision by proposing that older, existing connections are effectively guaranteed with curtailment limits that are not currently in their connection agreements and where such limits have been determined based on a DNO-specific methodology (unlike for a 'curtailable connection' under the Access SCR). Existing customers can of course make an application for a curtailable connection from 1 April 2023.

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- b) Existing systems have not been specified or built to provide the data necessary to operate this proposed incentive such that funding and implementation time would be required if this retrospective application was to be enacted. The absence of the necessary technology is a feature of the history of flexible connections where those connections have been provided at least cost to provide an automated system to curtail customers in certain situations when data was not required to provide the requisite customer service or comply with a regulatory obligation.
29. Over a lengthy process, the Access SCR working group has assessed and analysed how best to reform non-firm access arrangements. This culminated in Ofgem determining the approach to apply the charging reforms to new connections only from April 2023.
30. Most historical schemes are set up through hard coding in the protection settings and there is no way at present for data to be sent back to a central system for monitoring. The schemes work as they were intended to at the time and customers are happy with them. There would be a significant cost and time required to replace the equipment and central systems to start monitoring these connections.
31. The definition of ‘curtailable connections’ is wide. It does not distinguish between the size of the generator or the nature of the connection. There is a highly practical concern over the extent of any retrofitting of equipment required to monitor and report on the automated curtailment actions being taken. Flexible connections have been utilised in different forms over many years and there would be the need to review the connection agreements for at least approximately 1,700¹ Northern Powergrid generation customers to identify, review and amend flexible connections to capture data for curtailment reporting. There needs to be a balance between the regulatory burden and the benefit realised in doing so.
32. Many flexible arrangements have been set up historically to allow customers easier or cheaper access to the network. These customers benefitted from these provisions. If at any point a customer becomes unhappy with their flexible connection, they can apply to modify their connection and upgrade to a more firm supply. At this point they will be provided with the cost of modifying the connection accordingly and they will benefit under the post-Access SCR conditions for curtailment if a curtailable connection is the outcome (and within the boundaries of this metric). This logic, supported by the Access SCR decision, is being ignored in the discussion around application of this metric retrospectively. We have not seen any evidence to support retrospective

¹ Northern Powergrid connected generators of above 50kW installed capacity

application, whereas, in contrast, the Access SCR went through extensive due process for Ofgem to arrive at its decision.

33. We note that, in the 4 October 2022 working group meeting, the case for retrospective application was identified as ensuring that the measure could 'go live' in the first year of the ED2 period with operational generators that could provide the necessary data. This is a weak and insufficient justification to discard and over-write the Access SCR decision by incentivising retrospective application.

34. In paragraph 5.4 of the proposed governance document, Ofgem now proposes that, for the regulatory year commencing on 1 April 2023, the financial incentive value associated with the outturn performance metrics will be zero. This removes the time pressure and further weakens the case for retrospective application.

6. Methodology for determining an award

35. These arrangements appear reasonable.

7. Reporting and publications

36. These arrangements appear reasonable.