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Dear Eleanor

Business Plan 2 (BP2) Draft Determinations – Electricity System Operator (ESO)

This letter is in response to Ofgem's RIIO-2 Business Plan 2 (BP2) - ESO draft determinations (and associated draft guidance documents) for National Grid ESO (NGESO) and is being submitted on behalf of SSE Thermal and SSE Renewables.

We welcome the opportunity to comment on the proposed treatment of NGESO's Business Plan for the two-year period starting 1 April 2023. It is important that NGESO is able to meet the ongoing challenges associated with decarbonising the energy system whilst remaining resilient and cost effective.

Funding

We note that Ofgem proposes to fund the full totex request of £671 million for BP2 despite this being an increase of circa 25% from the latest BP1 expected spend, which itself is a significant increase from BP1 forecasts. We recognise that this sits against the very clear need to invest in the system and the supporting framework to deliver the network necessary to meet net zero. We would expect some of these costs to be driven by one-off projects (for example to deliver a particular IT improvement or the proposed transitional arrangements). Where this is the case, Ofgem should clearly identify and ring-fence these one-off costs to ensure transparency of underlying changes in costs at future reviews.

However, whilst we understand the points made around the need for NGESO to be funded in a way that enables it to deliver the level of transformation needed, users of the network understandably seek assurances that the allowances being made appropriately incentivise NGESO. NGESO should rightly be rewarded for any efficiencies it delivers, but equally it is key that cost inefficiencies are treated appropriately and not simply passed through to market participants. To this end, we welcome the proposed and more detailed ongoing monitoring framework. It is important that this framework identifies issues early and gives Ofgem the transparency necessary to deal with issues appropriately.

In line with the above, we support Ofgem's proposal not to increase the additional funding mechanism. Whilst we accept there are risks and uncertainties faced by NGESO, we consider the case for increasing additional funding has not been made. Specifically, there is not sufficient clarity around the need for more funding or that these risks cannot be managed within the existing funding envelope.

Similarly, whilst we understand the need for innovative solutions to the challenges facing NGESO, we are concerned that Ofgem is proposing to increase its Network Innovation Allowance (NIA) by £22 million

without a clear plan from NGESO for measuring the benefits of innovation projects and where appropriate rolling them out more widely. It is important that the benefits of innovation (however it is funded) flow through to business-as-usual activities and in turn reduce the costs faced by network users.

Lastly, with regards to funding the costs incurred by NGESO in transitioning to the Future System Operator (FSO), we have some reservations around Ofgem's initial thinking that these would be treated as a new pass-through item within NGESO's licence and subject only to a reputational incentive and reporting framework. The scale of these costs is not yet clear, but they have the potential to be significant and whilst we understand that Ofgem does not want to place barriers in the way of this transition, we believe it is important that users of the network are adequately protected from any additional costs. We consider it would be appropriate for Ofgem to wait until there is greater clarity on the structure and costs of the FSO before deciding how those costs should be treated.

Performance and outputs

It is important that NGESO's business plan drives the 'right' behaviours and its incentive package is set up to deliver this. With this in mind, we have set out, at a high level, the underlying requirements that we see as being key in the development of NGESO's performance and outputs settlement:

- **The importance of accurate forecasting:** Forecasts produced by NGESO influence market behaviour and will have a direct impact on prices. We believe more transparency and communication, in relation to both its demand forecasting metric and wind generation forecasts, is needed. These forecasting metrics can inform and drive the right market behaviours and responses from the outset and are arguably more efficient than retrospective, reactive measures. Ensuring these forecasts are as accurate as possible and do not limit market participants' ability to properly assess market conditions, should be a key priority and may warrant a substantive review of existing processes.
- **The need to avoid unintended consequences:** It is key that Ofgem does not inadvertently create perverse incentives.
 - (i) We are mindful of Ofgem's proposals to target phasing out of non-competitive balancing services. While we understand the drive towards competition, it is key that the role of 'non-competitive' balancing services is understood. Incentivising NGESO to stop securing contracts with specific assets in advance of gate closure risks significantly increasing the total cost of balancing. We would caution against the proposed changes to the metric unless it can be clearly demonstrated that those services Ofgem is trying to phase out are not providing value for money.
 - (ii) Similarly, incentivising NGESO on the basis of day-ahead pricing may be counter-productive in certain scenarios (for example, where a locational need is known). It is important that NGESO has the latitude to procure services using the full range of options available to it in order to deliver the lowest possible balancing costs.
- **The need for improved transparency:** Improved transparency on NGESO's forecasting and operational decision making is a common theme that would enable Ofgem and industry to more clearly understand inefficiencies / areas to target future improvements and focus, whilst alleviating the risk of creating perverse incentives. In any case, this greater transparency is a requirement of the Energy Data Taskforce conclusions that we would expect to be reflected in NGESO's approach to all data.



More specifically, we welcome Ofgem's proposal to include a new metric for NGESO performance with respect to connection offers. The connections offer process is a key part of the framework necessary to deliver net zero and Ofgem's proposal to place greater focus on the timeliness and quality of connection offers is a welcome step in terms of targeting network users' concerns in this area. However, we are mindful of potential inconsistencies between this new metric and NGESO's work to bring about Connection Offer reform. We wrote to Ofgem at the start of January expressing our concerns over some of the changes being proposed through this work being led by NGESO and the lack of meaningful industry engagement in that programme.

We also welcome the focus Ofgem has placed on considering whether the existing metric for balancing costs remains appropriate given the current climate. However, in line with concerns raised above, we are not certain that day-ahead wholesale prices will result in a more reflective ex-post benchmark. There is a risk that day-ahead prices will systematically understate NGESO's real time price exposure. It is not always possible to know how much impact proposals will have in achieving their aim or what unintended consequences there might be, therefore, it will be important that the effectiveness of any changes are closely monitored and reviewed in due course.

Finally, in terms of process, we broadly agree with Ofgem's proposals to streamline the approach for within-scheme feedback over BP2. Industry engagement and monitoring should be targeted at where it can add real value with a light touch approach being used where appropriate. In our view, the proposals appear pragmatic and strike a reasonable balance that should still provide parties with the appropriate opportunities to engage and have issues addressed as appropriate at relevant points during BP2.

Next steps

With Ofgem expected to publish its final determinations in March, we hope this gives Ofgem sufficient time to reflect and respond appropriately to the points made in this response. In turn, we look forward to Ofgem's upcoming consultation on the detailed arrangements for the FSO transition and increased clarity on the Connections Offer Reform work.

Should you wish to engage on any aspect of the above in the meantime, please do not hesitate to get in touch and we will do our very best to help.

Yours sincerely,

Sheona Mackenzie
Regulation Manager