Scottish & Southern Electricity Networks
TRANSMISSION

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18 January 2023

Dear Eleanor,

Response to the Draft Determination Consultation on the ESO's Business Plan 2 over the 2023-25 Regulatory Period.

We are pleased to enclose a response from SSEN Transmission[1] to Ofgem's Draft Determination Consultation on the ESO's Business Plan 2 (BP2).

As we have previously noted[2], we have an important working relationship with the Electricity System Operator (ESO). The ESO continues to demonstrate positive results in the work it does in many areas. Given the national importance of effective network development and secure operation of the transmission network, we believe it is also important to highlight where the ESO's Business Plan 2 can be improved.

In our response we have highlighted some areas where we would encourage the ESO to take into consideration, and for Ofgem to consider in its Final Determination of the ESO's BP2. A summary of the key points raised in our response is noted below.

Summary of key points

Incentives framework consultation questions

- We support stakeholder engagement on BP2 and aligning it with FSO and reform engagement.
- TOs will need clarity on who will be on the performance panel and what their respective roles and responsibilities will be.

Outputs consultation questions

- We suggest having a detailed framework for how performance improvements will be incentivised and improved, taking account of the financial and reputational impact on network operators.
- The CBA fails to deliver a network that seeks the most cost-effective way of reaching net zero.
- Consideration of the impact on TOs in supporting the ESO in terms of FTE would also be welcomed as we begin to prepare for the next price control commencing in 2026.
- Further consideration should be given to a Quality of Connections (QoC) equivalent for the ESO.
- In our view the metrics proposed for Role 3X are unlikely to be delivered due to the way that connection offers are developed.

[1] References to SSEN Transmission encompass the licenced entity Scottish Hydro Electric Transmission Plc Registered in Scotland No. SC213461.
[2] SSEN Transmission's response to the ESO's Performance over the 2021 Regulatory Period submitted 29 October 2021.

- It is unclear how allowing for revision of demand forecasting based on demand reduction services will demonstrate accurate forecasting. It should be considered in the original forecast rather than a revision.
- We suggest using a similar metric to that of TOs, such as the Quality of Connections process, in the performance benchmarking of the ESO's stakeholder satisfaction results using the 1-10 scoring.

Cost consultation questions

- In terms of Nodal Pricing, we recommended that further analysis and stakeholder engagement on design and implementation is built into BP2 to explore the clear concerns of those stakeholders and justify ESO positions.
- In terms of competition, we recognise that competition policy sits with Ofgem and Government, it is our view that the net consumer benefit of introducing competition 'for the market' in electricity transmission has yet to be demonstrated.
- We do not support the value for money scoring proposed by Ofgem as 99.8% of the ESO's spend proposal has limited justification, with 0.2% of the spend sufficiently justified. We are in favour of maintaining a higher justification threshold to demonstrate value for money.
- In terms of the code modifications, we would welcome specific resource being committed to managing a potential increase in modification proposals from stakeholders.
- We do not see the inherent value in removing the mid-scheme review periods.

FSO consultation questions

- We believe that the transition to the FSO should be cost-effective and transparent. An incentive framework which involves stakeholder feedback, a programme with clear KPIs and milestones will help to achieve this.
- We are also supportive of any FSO transition that has demonstratable consumer value, to which the ESO is held accountable to deliver.
- Currently, we are unable to see sufficient justification in terms of consumer's best interest for the proposed position on the FSO.

We have responded to the relevant questions, outlining the points above in more detail, within the attached appendix.

We hope these views are helpful and constructive, but should you require any further information please feel free to contact me.

Yours sincerely,

Subhan Shahid
Regulation Analyst

Appendix: Our Response to the Consultation Questions

Consultation Questions:

Incentives framework consultation questions

1. Do you agree with our proposed approach to within-scheme feedback, including the timings and approach to performance panel sessions?

We welcome the review of the ESO's feedback scheme and we appreciate the important role the ESO has. It is important for stakeholders to be able to hold the ESO to account in crucial periods of change, particularly when considering the increase in costs, IT changes and institutional reform. We consider that any stakeholder engagement on BP2 should be aligned ongoing with FSO / reform engagement.

In relation to the proposal of having a performance panel session to determine the ESO's performance biannually (replacing the current mid-scheme review process and end of year review that stakeholders inputted into) there is a need to clarify who will be on the performance panel and various roles and responsibilities.

Outputs consultation questions

4. Do you agree with our proposed changes to the ESO Roles Guidance? Are there any areas we have not captured in our expectations?

We are supportive of changes to the ESO Roles Guidance in part. In terms of the connection offers reform and the monitoring of the ESO's performance on connection offers, there is a financial and reputational impact on network operators. We suggest having a detailed framework for how performance improvements will be incentivised and improved.

Whilst we support new policy proposals that focus on timely and efficient delivery of infrastructure and provide confidence in delivery to system users, we note that the supply chain and other relevant stakeholders are needed to meet net zero given the pace and scale of investment required. We therefore agree that the Network Planning Review should be a new and important area of work for the ESO in BP2. We support this new area of work as a "cross-cutting" activity under Role 3 and encourage the ESO to further set out the governance arrangements for this activity, to demonstrate and ensure that interlinkages and overlaps are managed across activities. This is particularly important as policy that determines roles and responsibilities across those activities is still evolving. Further, it will be important that the review considers the current Cost Benefit Analysis (CBA) undertaken to determine network reinforcements.

The scope of the current planning processes which focuses mainly on bulk power flows is not currently well aligned to local and regional network needs. Despite the strong net zero imperative, we would urge that the planning review considers the appropriate accounting for carbon abatement in the CBA process. There is a risk that the use of scenarios in the CBA do not deliver net zero and can be self-fulfilling rather than the CBA seeking the most cost-effective way of achieving net zero. The CBA delivers a network that fails to do so. Therefore, we consider the focus of the CBA should be to determine the most cost-effective way of achieving net zero. We also encourage Ofgem to consider the impact on consumers owing to the risk associated with exposure to high and volatile constraint costs (that fall on today's consumers) and compare to the *lower risk* associated with stable, long term network

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investment costs that are spread across consumers now and in the future. Finally, it will be important that the planning review and the assessment for network reinforcements considers local communities, wider socio-economic and environmental impacts more widely and in a balanced way when making investment recommendations. A review of the CBA will also cut across other developing policy areas like the Central Strategic Network Plan (CSNP).

In addition, an important focus for the ESO under this activity should be engaging with relevant industry stakeholders, including the transmission owners (TOs) who hold relevant expertise on this activity area, and who will be impacted by its implementation. We are encouraged that the ESO has recognised the importance of stakeholder engagement and considered the FTE impact of doing so (consideration of the impact on TOs in supporting the ESO in terms of FTE would also be welcomed as we begin to prepare for the next price control commencing in 2026). We would welcome further demonstration on how the ESO plan to engage with stakeholders on these cross-cutting themes within the business plan.

6. Do you agree with our proposed changes to the performance metrics for BP2?

It is unclear to us how the percentage of renewable demand will be determined in balancing costs, particularly due to the marginal wholesale price which is based on the last generator (which may not be renewable) to export onto the network to meet demand. In terms of the demand forecasting changes, allowing for revision based on demand reduction services, it is unclear how this will demonstrate accurate forecasting and should be considered in the original forecast rather than a revision. Additionally, we would appreciate an indication about the thinking behind the proposed locational tag for wind generation forecasting. We have also considered the competitive procurement changes and are looking for clarity from Ofgem about what is meant by phasing out non-competitive procurement.

Further consideration should be given to a Quality of Connections (QoC) equivalent for the ESO. We have seen concerns raised by customers and stakeholders who are unable to receive a response from the ESO in a timely manner. A mechanism which incentivises delivery of improved customer service by the ESO could be beneficial. As currently designed, the proposals do not incentivise a positive service for customers, only for the ESO to deliver against a schedule.

7. Do you agree that the full suite of metrics provide a comprehensive view of measurable ESO performance? If not, what is missing?

We welcome engagement on the metrics that aim to provide a comprehensive view of measurable ESO performance. In our view the metrics proposed for Role 3X are unlikely to be delivered due to the way that connection offers are developed. The process currently centres around a 90-day desktop study undertaken by TOs that is then passed to the ESO to turn the study into an offer to the customer. Further development of the technical solution, land and routing requirements are assessed and then costs updated resulting in further offers being issued. We would appreciate further clarity on how the proposed changes to Role 3X takes account of customer-led Mod-Apps to avoid securities.

It is also worth noting that as the FSO transition is yet to be consulted on, many of the metrics will need to be considered at a later stage.

8. Do you agree with our proposed changes to the performance benchmarks for measuring stakeholder satisfaction?

We appreciate the proposal to change the performance benchmarks for measuring stakeholder satisfaction and We suggest that a similar metric be implemented, as seen within the QoC process, whereby TOs are scored out of 10. It is an effective metric to provide stakeholder feedback clearly and effectively on the level of satisfaction stakeholders have with the ESO's performance.

9. Do you agree with our proposed changes to the regularly reported evidence for BP2?

We welcome changes to the regularly reported evidence for BP2. Our understanding of the changes proposed suggests there is a need to increase transparency through allowing feedback reports to be published. We consider this approach will lead to additional clarity for stakeholders.

Cost consultation questions

10. Do you agree with our proposal to approve the ESO recovering its full BP2 funding request of £671m?

We are unable to assess whether the funding request of £671m is appropriate as there is insufficient information provided on how the figure is calculated.

11. Do you agree that the activities and investments proposed by the ESO are necessary and should proceed?

Nodal Pricing

Given the scale of change Nodal Pricing requires (ultimately a recommendation from the Net Zero Market Reform project), we expect reaching such a conclusion to be thoroughly evidenced by extensive stakeholder engagement and supporting analysis by the ESO. The RIIO price control is stakeholder-led, taking any position or view that is contrary to the majority of stakeholders should be clearly articulated and justified. We recommended that further stakeholder engagement is built into BP2 to explore the clear concerns of those stakeholders and justify ESO positions.

The approach used in the NZMR project and the resulting announcement for Local Marginal Pricing (LMP) was underpinned by a lack of evidence surrounding the cost effectiveness of Nodal Pricing within the GB market. Although evidence was published in May, several months later than the announcement in March, it failed to expand on or address concerns within industry and it failed to fully explore the impact of nodal pricing across a range of 'stress testing' scenarios.

If we are to achieve a Net Zero system in GB, the impact of industry reform on investor confidence is crucial. Such an extensive reform to market design and its inevitable uncertainty will affect the time critical investment needed to deliver Net Zero. In addition, the associated pass-through costs will lead to an increase in the weighted average cost of capital (WACC) and subsequently impact consumers. Given the likelihood of this consumer impact we expected further analysis and evidence in this area to have been undertaken. As the TO for the north of Scotland, the interest of generators in our jurisdiction is critical to our business. Nodal Pricing will have a material and commercial impact on north of Scotland generators, fundamentally impacting business plans and potentially negatively impacting projects in the early stages of development. The proposed mitigation for the increased risks nodal pricing will pose to Scottish generators, Financial Transmission Rights (FTR's), has limited mention of May's publication.

We therefore recommend that further analysis and engagement on the design and implementation of nodal pricing and FTRs are built into BP2.

In relation to market reform and any other substantive reform it should be recognised that the ESO has a critical role to play in holding important industry data. In particular data relating to constraint costs and modelling. To ensure that relevant and critical stakeholder input and feedback is received, it is important that the ESO has appropriate open and accessible data sharing practices in place.

Competition in onshore transmission
Whilst we recognise that competition policy sits with Ofgem and Government, it is our view that the net consumer benefit of introducing competition 'for the market' in electricity transmission has yet to be demonstrated. We have serious reservations about mechanisms that will lead to fragmentation in ownership and responsibilities resulting in subsequent inefficiencies and lack of accountability. We are also concerned that early competition will divert resource away from the delivery of onshore projects already identified as required to deliver net zero ambitions. Delay to delivery of networks risks failure to meet net zero targets, increased carbon intensity of our generation mix, and increase in costs to consumers through constraints.

It is imperative that new activities on onshore competition do not delay those critical infrastructure projects required for net zero to go ahead in the near term. We look forward to continued engagement with the ESO on its development of plans for early competition in due course and will provide more detailed feedback to the proposals in implementation workstream discussions.

We agree that this activity has several dependencies with other activities (FSO, Network Planning Review, Offshore Transmission Network Review (OTNR)) which are all interlinked. There remains a lack of clarity on how these activities will align and play out over the varying timescales of implementation.

As work on early onshore competition progresses, it is imperative that key stakeholders are involved and consulted at every stage. We note that the ESO will be responsible for project specific cost benefit analysis. Key stakeholders, including the TOs, must be involved in the development of methodologies proposed for the CBA. We consider appropriate to include stakeholder management planning within this activity (i.e., ensuring stakeholder concerns are recorded and addressed appropriately before progressing with a proposed CBA).

12. Do you agree with the proposed Value for Money scoring?

We do not support this proposal. There is limited justification on 99.8% of the spend proposal meaning that 0.2% of the spend proposal is sufficiently justified, a point which Ofgem acknowledges in the consultation. We expect a higher justification threshold will be required to demonstrate value for money.

In terms of the consultation position for Role 2 of the ESO, we agree with Ofgem that the deliverables and outcomes of A6.1 Code management/market development and A6.8 Digitalisation of code under the activity, should be better set out and ensure that there is no overlap with Energy Code Reform. In particular we welcome detail of how the ESO's 2025 objective, that code governance will be an enabler of net zero, can be achieved with industry and duty holders to the ESO's codes.

We would also like to understand how the Whole System Code work that seeks to harmonise Grid Code and SQSS does not create a conflict of interest. Grid Code stipulates what users must account for in their systems. SQSS covers how TOs plan the network. To have both in one code could lead to users being able to change what they must do and thus dilute the security and resilience of the network. We agree that the ESO can show strong leadership in this area. This would include working with Ofgem to formalise and align code objectives for delivering net zero and ensuring an overall objective that code reform maintains the safety, reliability, and economic operation of the energy system and networks. Leadership would include:

- Seeking stakeholder (customer) views on Energy Code Reform proposals including Code Manager roles and responsibilities.
- How this would work with FSO responsibilities to ensure there are no conflicts of interest; and
- The role the ESO can play in developing codes and governance to ensure the requirement to prioritise the safety, security, reliability, and economic operation of networks (and other relevant systems and services) should be maintained as an overarching priority within the terms of reference of any revised institutional framework, and options for formalising a net zero objective within codes.

In reviewing the potential governance procedures for Stakeholder Advisory Forum, the ESO should recognise what works well within the existing governance procedures, in particular formalised representation (including TOs) for duty holders in Panels, and recognition that the codified make-up of the STC Panel currently reflects appropriate representation for duty holders and impacted parties.

The ESO can proactively share their views on code consolidation options and the roles and responsibilities of potential Stakeholder Advisory Forums with stakeholders and seek feedback from customers.

The ESO should not seek enabling access for new parties as a goal in itself. Instead, the overarching principle should be to ensure access for signatories and impacted parties within codes through proactive stakeholder engagement. This would include ensuring that code governance duty holders, including network licensees, must have formal and codified involvement in the process of code change, be able to assess code change via consultation against code objectives, and hold any code manager function to account where a change impacts upon the safety, security, reliability, and economic operation of networks (and other systems and services as relevant). There should be formalised and codified roles and representation within SAFs for duty holders.

One of the goals set by BEIS for Energy Code Reform is to ensure that what works well is maintained, the ESO have a key role in achieving this. Where the existing Panel make-up, such as in the STC and SQSS Panel, appropriately reflects duty holders and impacted parties, the codified forum make-up should not be unnecessarily changed. Further, they have a key role in addressing what doesn't work well. Current governance structures have inherent barriers to the voices of some parties being heard, for example, we are consistently impacted by CUSC modifications, yet we are not signatories so have limited influence on modification.

The increased headcount for codes should be appropriately balanced between code reform and existing code governance procedures. This would help address Ofgem's concerns regarding the efficiency of the current code change process. We would welcome specific resource being committed to managing a potential increase in modification proposals from stakeholders as they are impacted by wider policy reforms that are driving the ESO's own agenda for modification proposals, driving efficiencies in the code governance process, and enabling the transition to the Energy Code Review (ECR) governance structure.

We recommend that the ESO consider how they use the additional resource to manage the transition to new governance under the ECR. Consideration will need to be made for how in-train modifications will be managed, and how new modifications will be assessed during a transitional period. By committing time and resource to this within BP2, it will allow for clear communication lines with customers and stakeholders to shape this process as more guidance comes out. This is important as resource planning, investment decisions, and benefits cases will need to be made by customers and stakeholders as to whether to commit to the current process or await the new one.

BP2 acknowledges that code changes are required to achieve certain policy objectives and has detailed new deliverables. Given that these changes will affect stakeholders there is the possibility that the changes will not only drive the need for ESO proposed modifications but will also drive an increase from existing and new stakeholders seeking modifications to realise customer benefits and meet net zero objectives. We recommend that the ESO consider in BP2 whether further specific resource would be required in the future in response.

13. Do you agree with our proposed approach to monitoring the ESO's costs?

We are supportive of a cost monitoring framework which we believe is urgently required. The current uncertainty mechanism is undefined. In terms of removing the biannual reviews from the ESO mid-scheme review, we believe that the scheme allows TOs to provide feedback to the ESO on a regular basis and address concerns quickly and effectively. We appreciate that the cost is ultimately borne by consumers and the ESO is funded through a regulatory framework, as such we do not see the inherent value in removing the mid-scheme review periods.

14. Do you agree with our proposal to not change the disallowance cap value for BP2?

We do not agree with this proposal given the significant increase in costs, which have not been sufficiently justified. The result is a potential push of risk onto the consumer with over inflated costs.

15. Do you agree with our proposal to not increase additional funding for BP2 based on the current information available?

We welcome engagement on this point and would highlight the consultant IT report commissioned by Ofgem that stated the costs were insufficient.

17. Do you agree with the level of proposed NIA funding for the ESO? If not please outline why.

TOs have not had the same opportunity to increase innovation funding despite tackling the same network wide issues.

FSO consultation questions

18. Do you agree with our intention to fund the ESO's efficient FSO transition costs through a mechanism set out in the ESO's licence, and that this should not be classed as Totex and therefore not added to RAV? If not, please detail why.

It is yet to be seen how Ofgem will determine which costs are efficient and how the roles, responsibilities and governance will be developed to ensure there is no overlap or duplicated efforts. We agree with the approach to fund the ESO's efficient FSO transition costs through a mechanism set out in the ESO's licence, it should not be added to Totex or RAV as this spend is for future FSO activities.

19. Do you agree with our proposals for a regulatory and incentive framework for FSO delivery? If not, please outline why.

The detailed incentive mechanism is yet to be developed by Ofgem, although as noted previously, we believe that the transition should be cost-effective and transparent. An incentive framework which involves stakeholder feedback, and a programme with clear KPIs and milestones will help achieve this. We are supportive of any FSO transition that has demonstratable consumer value, to which the ESO is held accountable to deliver, much like the CVP of RIIO-T2. Due to the importance of the transition to the FSO, we would appreciate guidance on when the TOs will have the plans for transitioning to the FSO shared with us.

We believe the regulatory and incentive framework for the FSO delivery should include interdependencies with other market reforms which involve the FSO such as the Energy Code Review, REMA and the Centralised Strategic Network Plan (CSNP). We also agree with a reputational, rather than financial, incentive and are supportive of the authority issuing a public statement to ensure the ESO is held accountable for the transition. We further agree with Ofgem's approach to make it as streamlined as possible and align it with BP2. As noted previously, Ofgem will need to carefully consider any duplicated efforts on cross-over activities if funded under separate BPs.

The independence of the ESO has also been a key element of their BP and BP2 including licence drafting; we would urge Ofgem to transfer existing responsibilities with minimal disruption to the sector. Stable and strategic planning for Net Zero across GB and across vectors should be the focus of the FSO given the challenges of operating a net-zero system and ensuring security of green supply.

We have further comments in terms of the FSO going forward we feel Ofgem should consider. We believe the FSO's priority should be to manage both balancing the grid and a holistic national GB planning role in the future system planning of the network. Balancing the grid is expected to become more complex. The ESO recently outlined in its capacity adequacy report that: *"if all technologies fail to come to fruition the GB system will struggle to meet security of supply"*. The challenges of operating a net-zero system by 2035 are significant. The above infrastructure needs to be considered on a system level, this means beyond the physical asset investment to the invisible and complex operation of balancing the system against changing weather patterns. The CSNP must consider both the assets, and operation of assets, to ensure capacity adequacy and security of supply when both the supply (renewables) and the demand become increasingly green (through the electrification of heat and transport). Dieter Helm summarises the issue: *"There is no way the transition to net zero for the power sector can be completed without networks being in a good shape to achieve this objective and at the same time ensure security of supply. Electricity transmission and distribution need not only to support*

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the current and growing demands for electricity, but also to meet the new requirements, for electric transport, decentralised generation (including households feeding into the grid), the ability to handle lots of intermittent small-scale renewable generation, air conditioning, and heat pumps, and the growing demand to support the digital economy. Neither the grid nor the distribution networks were designed to handle any of these demands".

It is in the interest of the GB consumer to minimise the amount of 'critically tight periods' in the future which could cost the GB consumer £5,000 per MWh during these events, as outlined by the ESO in their capacity adequacy report. The ESO (FSO) will continue to be reliant upon regional Transmission Owners who are best placed to understand local system needs and plan the system effectively. As outlined in our previous response sub-national (as referred to by Ofgem in their FWP) is not of sub-importance but the foundation of the FSO's holistic GB planning. TOs own and operate the local network assets and have decades of experience in planning and operating these assets in conditions (including weather conditions) unique to their locations. Within the investment process we aim to ensure significant transparency with stakeholders, landowners, and communities through timely engagement. We believe there is benefit to the FSO holistically planning the network at a GB and cross sector level with regional TOs. Network systems are complex systems with complicated interdependencies.

We would urge Ofgem to consider GB national and cross-sector planning to be the main focus of the FSO policy development rather than a future consideration; this is supported by the NIC[3]: *"Accelerating the implementation of the British Energy Security Strategy to finally update the mandate of Ofgem, create the Future System Operator which is essential to a holistic approach to solve the challenges of our future, multi-fuel energy system and accelerate the connection of our cheap renewable generation"*

It is these concerns that might call the scope of works into question and may complicate Ofgem's regulation of the FSO. We would appreciate further details on the roles, responsibilities, and governance.

We appreciate the position proposed for the FSO however, we are unable to see sufficient justification in terms of consumer's best interest. It is not clear how the FSO will deliver net zero whilst maintaining a resilient and affordable system. We are supportive of clarity in this respect.

3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1128689/mission-zero-independent-review.pdf