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Dear Giuseppina,

**RenewableUK consultation response REF 106/12**  
**SYSTEM OPERATOR INCENTIVE SCHEMES FROM 2013 INITIAL PROPOSALS**

**Summary**

RenewableUK welcomes the opportunity to comment on Ofgem's proposals for the System Operator Incentive schemes. Our comments are presented in the context of the ongoing, long-term transformation of the electricity industry, where the SO needs to innovate and develop new activities, while ensuring that the overall cost of the system, and charges to generators and consumers, are not excessive. Accordingly, we believe:

- **Gone Green should be the baseline scenario, behind which all of NGET's activities should be aligned.**
- **Use of the existing balancing services modelling tool should be retained if possible, and network investment encouraged to reduce constraint costs.**
- **It is right to encourage SO-TO interaction. This should be supported by a mapping of how wider network investment reduces SO costs and charges.**
- **Wind forecasting is a vital part of the role of the SO, and it is not clear why it has not been treated with more importance up until now.**
- **The innovation allowance should allow the SO to innovate with confidence, and incentivise the roll-out of effective innovation with stakeholder input.**
- **It is right to introduce the broad environmental incentive, but it should not be undermined by uncertainties within the main allowance.**

## **Introduction**

RenewableUK is the trade and professional body for the UK wind and marine renewables industries. Formed in 1978, and with over 660 corporate members, RenewableUK is the leading renewable energy trade association in the UK, representing the large majority of the UK's wind, wave, and tidal energy companies. The association's response aims to represent these industries, aided by the expertise and knowledge of our members.

Our comments are presented in the context of the ongoing, long-term transformation of the electricity industry, where the SO needs to innovate and develop new activities, while ensuring that the overall cost of the system, and charges to generators and consumers, are not excessive.

## **Playing a Full Role**

We very much welcome Ofgem's reiteration of the need for the SO to play a full role in the transition to a low-carbon economy, including: proactivity, delivering long-term value for money; thinking innovatively about market operations and trading arrangements; and working with others to take account of interactions.

We believe the RIIO-SO incentives should encourage this comprehensive approach. At a time of transition, there needs to be a balance between one overall incentive, and several more specific incentives, and our response reflects this.

We note in the RIIO-T1 consultation that Ofgem has qualified its "best view" of the Gone Green scenario by introducing a greater downside risk, on the basis that new generation capacity will be less than that in the scenario. We are seriously concerned that this immediately sends the wrong message. – At a time when discussions both in policy terms and in the media are about how an increasing penetration of variable renewable generation will be accommodated on the system, the SO should be gearing up towards achieving the Gone Green scenario and beyond. There is a danger that lack of SO preparedness for high renewables penetration will yield a self-fulfilling prophecy.

We note Ofgem's recent consultation on its approach to "Strengthening Strategic and Sustainability Considerations in Decision Making,"<sup>1</sup> in which it recognises wider considerations, and in our response to this consultation we have argued that it is important to incorporate wider short-term effects as well as medium-term and long-term effects. These effects include the cost of delays, uncertainty, and loss of momentum. We believe all of these issues should be taken into consideration.

In summary, we encourage Ofgem to incentivise the SO to prepare fully for, and facilitate, the achievement of the Gone Green scenario, as part of playing a full role in the transition to a low-carbon economy.

### **Balancing Services Costs**

We understand Ofgem's concerns about the accuracy of BSIS modelling, and therefore its usefulness as an incentive for the SO to reduce balancing services costs moving forwards. Ofgem is proposing a more hands-on, annual management approach until the issues with modelling accuracy are resolved.

This is a difficult judgement. On balance, RenewableUK believes there is benefit in sticking to the existing incentives scheme, on the following basis:

- The mechanism of the scheme, if not its accuracy, is established, unlike any new arrangements.
- The scheme can be used to encourage long-term investment, unlike management of an annual allowance.
- A claw-back on inefficient actions would push the SO to be more risk-averse.
- A discretionary reward on benefits over "business as usual" would necessitate modelling of BAU that seems to take us back to modelling accuracy.
- The best and most cost-efficient way of improving the accuracy of the model is through using it.

The above notwithstanding, it is important for the SO to be incentivised to improve the accuracy of its modelling, and a peer review process to this end would seem appropriate. It is also essential that the financial incentive to reduce constraint costs translates into timely decisions on investment in further network capacity.

### **SO-TO Interaction**

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<sup>1</sup> [www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=Sustainability](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=Sustainability), July 2012

RenewableUK strongly supports a greater and incentivised interaction between SO and all TOs. Renewables generators are keen to generate as much power as they can onto the system, and not be constrained off.

We understand that work on the TO-SO interaction is being undertaken under the Network Access Policy. We would like to point out the importance of taking a wider view of system costs. We would like to see a mapping of how investment in grid development will reduce constraints, thereby reducing constraint costs, leading to a reduction in overall system costs, and ultimately a reduction in costs both to generators and to consumers.

The financial incentive on transmission losses is an example where the SO has less impact and the incentive may have perverse consequences. It may therefore make sense for it to be removed.

### **Market Facilitation**

We noted from the NGET Talking Networks event the proposed market facilitation roles of the SO. Items of particular relevance to the renewables industry include:

- Customer service and support for smaller generators
- Opening up the markets for ancillary services
- Greater volumes of information provision to the market

We understand that Ofgem has reduced the allowance for this kind of activity by some £16M. We have no insight into the cost of such services, but we would stress their importance as part of the SO playing a “full role” in facilitating the transition to a low-carbon economy.

By supporting the connection of smaller generators, opening up the market for ancillary services, and providing more information to the market, the SO will be driving down its costs in operating the system (for example, balancing costs); and also driving down the cost of generation (by promoting competition), ultimately reducing the cost to the consumer. Ideally it would therefore happen automatically. However, at this point of transformation of the energy system, it seems helpful to have an allowance and/or incentive that encourages the SO to make explicit these links with wider system costs

## Wind Forecasting

RenewableUK very much welcomes Ofgem's attention on the provision of accurate wind generation forecasting, as one of the market facilitation services that the SO can provide. We believe accurate wind forecasting will help reduce the cost of a) reserve, by knowing what will be generated, and b) imbalance, by allowing more informed trading to balance positions. The value of accurate wind forecasting is high enough that EirGrid contracts with two external wind forecaster to provide two forecasts which can be used to benchmark each other and deliver continuing improvements.

Given this importance of wind forecasting accuracy, we are surprised that SO wind forecasts are not already more accurate. It is of concern that the linkage between wind forecasting and wider SO costs has not been established. RenewableUK has made several submissions to NGET (22<sup>nd</sup> Dec 2010, 16<sup>th</sup> Sept 2011, 11<sup>th</sup> May 2012), in which we set out thoughts and suggestions on wind forecasting, and these seem not to have been accommodated. It is not clear whether this is because there was no financial incentive, or whether it is just a misalignment within SO operations.

We suggest that, as part of the finalisation of the forecasting incentive, there is a need for an industry workshop to look at wind forecasting, including:

- how accurate forecasts benefit the SO's activities and bring down costs
- how the linkages between forecast accuracy and SO costs can be consolidated
- nature of forecast (how far ahead, accuracy depending on weather categories, market conditions, etc.)
- inclusion of embedded generation that is currently not measured by the SO, leading to a predictable error of some 25% or more in forecast accuracy
- options for producing accurate forecasts
- the appropriate incentive for forecasting, including competition between multiple forecasts and benchmarking
- implications for balancing arrangements (noting in particular Ofgem's current considerations of an SCR on energy balancing)

In summary, RenewableUK supports incentivising and rewarding the SO for accurate wind generation forecasts, but we first need to understand why these have not happened to date, and agree wider industry needs.

## **SO Innovation**

Under the RIIO-T1 proposals, we note that Ofgem has reduced NGET's proposals for innovation from 1% to 0.6%. If we understand correctly, the allowance also covers SO innovation. In view of the major changes to the energy mix, we would expect the SO to undertake extensive innovation activities, from control systems to balancing activities to development of a market for services. Many of these should be incentivised as part of the overall allowance to reduce balancing costs, but a portfolio of innovation projects allows the SO to take a slightly less risk-averse approach to innovation before roll-out.

It is right that broad themes for innovation should be justified, with a demonstration of how projects will be targeted and prioritised. We would also add roll-out to this list. We would support an incentive for the early roll-out of effective innovation.

Rather than reducing the innovation budget on the basis of lack of detail, we would support an appropriately sized innovation budget, with the detail developed through stakeholder workshops and systematic stakeholder engagement by the SO.

## **Broad Environmental Incentive**

Finally, we support the ongoing development of the Environmental Discretionary Reward (EDR). We believe this will have a galvanising role in aligning NGET's activities with the low-carbon agenda, including both the TO and SO. However, at £4M p.a. across all transmission owners, the EDR incentive is not huge. It is important that the very thing that EDR is trying to achieve – consolidation of SO activities behind the environmental agenda – is not undermined by misalignment and disruption to a cohesive, strategic development programme, caused by too many uncertainties in the RIIO-SO allowance.

In summary, we support the EDR and encourage Ofgem to consider how in practice its aims can be supported and not undermined by uncertainties in the overall RIIO-SO allowance.

Thank you for this opportunity to input. We would be happy to discuss our views further with you, and we look forward to working with Ofgem and NGET towards the implementation of the RIIO-SO package.

Yours sincerely,

Zoltan Zavody  
Grid Policy Team

## **Annex: Questions**

The specific questions posed are mostly discussed in our letter, and a summary answer is provided below for convenience:

**Question 1: In respect of transmission losses, do you agree with our proposal to put in place a reputational incentive and to remove the current financial incentive?**

Yes

**Question 2: Please provide your comments in respect of our proposals for an incentive on renewable forecasting.**

Yes, subject to consolidation of the linkage to wider SO activities; and an understanding of why it has not happened to date.

**Question 3: In respect of the incentive on energy balancing and constraint costs, do you agree that direct financial incentive should be removed?**

No

**Question 4: Do you agree that we should put in place a licence condition to enable us to disallow costs incurred by NGET if they are uneconomic or inefficient?**

No

**Question 5: Please provide your comments in respect of our proposals for a discretionary reward mechanism.**

Disagree

**Question 6: Do you consider that a cost incentive on black start should be retained?**

No comment



**Question 7: What are your views on NGET's proposals for commercial contracts with non-NGET TOs to incentivise them in respect of constraint costs caused by changes to their output plans?**

Agree