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Dear David,

**Re: Electricity System Operator incentives from April 2017**

On behalf of Electricity North West Limited, we appreciate the opportunity to respond to this consultation on future incentives for the System Operator (SO). We understand that this is an interim stage in the development of these incentives and are keen to contribute, where we can, to the immediate need and longer term shape of these incentives to the extent that they interact with electricity distribution.

To date, we have had very limited interaction with the SO incentives. However, as the sector is changing, the behaviours that are driven by the SO incentives, both intentional and otherwise, are increasingly having an impact on how the development of our activities. Our response is therefore focussed on the proposed new incentives within chapter three of your consultation document.

***Demand forecasting***

We agree that accurate short-term forecasts are an important component of the SO's ability to effectively balance the system in real-time. We also agree that this has become, and is likely to continue to be, increasingly challenging due to the continued rise in the levels of generation connected to distribution (and therefore not visible to the SO) and also the changing loads as customers adopt new technologies. Ultimately, the SO is looking at a net demand position when calculating these forecasts (i.e. total demand behind each Grid Supply Point minus distribution connected generation). As a consequence, the variables involved are even more challenging for the SO, distanced from the distribution networks, to assess.

We support the use of incentives to improve performance in this area. However, we also suggest that there may be merit in considering who is incentivised to provide these forecasts, especially as the industry evolves. It may be, for example, more appropriate for Distribution Network Operators (DNOs) to undertake a greater role in this area. As this was not envisaged in the ED1 price control, an appropriate and proportionate approach to funding this work will be required to be developed. For the remainder of ED1, this could be simply facilitated by the SO being encouraged to use its incentive mechanism to fund the provision of demand forecasting at a distribution level.

***Transparency and openness of procurement***

As part of our CLASS project, we have had a number of discussions with the SO regarding the procurement of balancing services. Whilst these conversations have been positive and

productive, the services procured have evolved little since BETTA and remain predominantly focussed on larger providers of services. As such, potential new offerings are required to fit into existing products that the SO has established a market for, leaving limited optionality to reflect more innovative approaches to procuring flexibility.

We note the suggestion that the SO makes greater use of auctions and similar approaches to procure services. Whilst there may be some merit in this approach, the very structure of an auction is likely to require the SO to be quite prescriptive about what it is seeking. This is likely to be suitable for established offerings that multiple parties are able to provide. However, it may not be effective in encouraging innovative options that require testing and collaboration with the SO in order that the SO can have confidence in the offering and that it meets the system balancing needs.

Introducing a mechanism that incentivises wider engagement with the potential market and encourages early and ongoing engagement with alternative providers may be more effective prescribing a particular approach to procurement.

### ***SO-TO funding***

We note the discussion regarding appropriate payment mechanisms where the SO requires one or more of the transmission owners (TOs) to undertake particular actions to facilitate wider system operation. However, we suggest that this mechanism should be broadened to cover all instances when the SO is looking for a response from a licensed network operator in relation to its assets.

We have been working with the SO and other DNOs through the Transmission : Distribution Interface Group established by the Energy Networks Association to better understand the increasing interfaces between the transmission and distribution networks. In a number of instances, potential distribution solutions to transmission problems have been identified. However, some of these solutions come with an additional, often incremental, cost, reflecting the benefits being provided by the solutions are beyond the outputs that DNOs are funded to deliver. Concerns have been expressed by a number of parties as to how these can be appropriately funded. Widening this mechanism to provide an explicit provision to enable the SO to fund transmission or distribution solutions to problems it identifies as likely to deliver wider system benefits is likely to deliver significant benefits to customers.

We hope the above comments will be useful in your development of the SO incentives package and would welcome engagement with you and the team, particularly in relation to the points raised above. In addition, if you have any comments or questions, please do not hesitate to contact us.

Yours sincerely

**Jen Carter**  
**Regulation Manager**