

Ofgem
9 Millbank
London
SW1P 3GE

23 September 2016

Attn: David Beaumont

Energy UK response to Electricity System Operator incentives from April 2017

Dear David,

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry from established FTSE 100 companies' right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

Introduction

Ofgem is consulting on its approach to System Operator (SO) incentives in the interim period from 1st April 2017 until a new SO incentive framework is ready, which is envisioned to be some time in Spring/Summer 2018. It is acknowledged that there is a need for a fundamental review of SO incentives in the consultation but this consultation is focused on how to approach SO incentives in the short term.

Approach to SO incentives in the interim period

Energy UK believes that it is important to continue with an incentive scheme over the interim period through to Summer 2018. Our members support the principle of driving greater efficiency in the actions and services procured by the SO to manage the transmission system, and the principle that it should be customer focused. The SO incentive scheme is the primary tool to encourage such efficiency and financial incentives are most appropriate for a limited, profit making organisation. We do not believe there is anything to gain by removing the scheme completely. It is particularly important in the context of Western (bootstrap) link that is due to be completed in 2017, which will have an impact on constraints and flows.

Energy UK agrees that the existing scheme should be rolled over during the interim period. This should be done with minimal change, i.e. removing elements that are no longer effective or incentivise actions out of line with longer term objectives.

Alongside improving the forecasting of BSUoS, one area of improvement that should be incentivised over the interim period is accuracy of short-term forecasting. This is crucial for a market with greater levels of decentralised generation and greater variability in short-term capacity availability. This is an area of work that the SO could be incentivised to begin preparatory work ahead of the enduring solution in 2018.

Enduring SO incentive scheme beyond 2018

Our members fully support Ofgem's plans to conduct a fundamental review of the SO incentive scheme. With that in mind, resource should be focused on the enduring solution, rather than attempting to fix an aging scheme that no longer meets the requirements of a rapidly changing system.

A key element of the enduring solution should be to incentivise greater transparency in SO's procurement actions and in real-time use of those services; for example transparency of Balancing Services Adjustment Data and Non-Balancing Mechanisms and Short Term Operating Reserve actions. As noted in our response to the proposed Income Adjusting Event earlier this year, Energy UK would support the SO's procurement processes being standardised, producing an open and transparent market that provides greater certainty to market participants. Energy UK suggests that publishing the procurement methodology is a critical first step. For further details on suggested ways in which the transparency incentive could work, please consider our members' individual responses.

Ultimately, when the SO takes actions using the services and products that they procure, there is an impact on the market, and so market participants should be made aware of these impacts in a timely manner.

SO-TO incentive

Energy UK sees that there may be some value in allowing the transfer of funds between the TO and SO, which are currently incentivised under two distinct schemes. This lack of interaction may mean that they fail to capitalise on potential efficiency savings across the two activities.

However, Energy UK members call for impact assessment to be conducted, to better understand the effect that this incentive scheme may have. Energy UK believes that this incentive, while proposed to be a short term incentive, has not been considered in enough detail, particularly in respect of the independence of the SO from TO activities. The consultation also does not give consideration to the relationships and impact of Competitively Appointed Transmission Owners (CATOs) and Offshore Transmission Owners (OFTOs), as well as interconnectors to the incentive suggested.

Further to this, Energy UK believes that while Ofgem is considering an SO to TO funding mechanism, Ofgem has not considered the potential for a reciprocal TO to SO arrangement. If the SO incurs costs due to TO actions, it may be logical for the TO to pay – such a mechanism should work both ways.

If you have any questions please contact me at kate.dooley@energy-uk.org.uk or 0207 747 2942.

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