

David Beaumont
System Balancing
Ofgem
9 Millbank
London
SW1P 3GE

Date:
15th September 2016

Contact / Extn:
Alan Kelly
0141 614 1736

Dear David

Electricity System Operator incentives from April 2017

This response is from SP Transmission plc (SPT) the onshore Transmission Owner (TO) for the South of Scotland. Thank you for the opportunity to respond to Ofgem's statutory consultation on System Operator (SO) incentives.

The need for a fundamental review of SO incentives

Balancing actions are becoming increasingly complex due to the rise of both intermittent and distribution connected (embedded) generation and the impact this is having on Grid System Operation and network demand. It is therefore, appropriate to conduct a fundamental review of the SO incentive arrangements but as this will take some time we agree an extension of the existing arrangements, with some amendments, is appropriate.

The potential changes proposed to the existing scheme are reasonable and provide an initial step towards the more fundamental review. In particular we welcome consideration of a longer incentive period. Our view is the current two year period limits the opportunities to minimise overall constraint costs associated with transmission network outages. A longer period is required to accommodate potential savings offered by, for example, using alternative substation design or build strategies.

What to do in the interim period

The proposal to introduce an SO-TO funding mechanism from April 2017 is a positive step that provides a mechanism to fund TO's to provide services in relation to network outages, that could reduce constraint costs for consumers. We highlighted this issue in the early stages of the RIIO-T1 period and initially engaged with Ofgem and the SO to seek a solution. More recently we have developed proposals with the Network Access Policy industry working group, that are largely reflected in the arrangements described in Appendix 1 of the consultation.

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT, Telephone: 0141 614 0008,
www.scottishpower.com

SP Transmission plc, Registered Office: 1 Atlantic Quay, Glasgow, G2 8SP Registered in Scotland No. 189126 Vat No. GB 659 3720 08
SP Manweb plc, Registered Office: 3 Prenton Way, Prenton, CH43 3ET Registered in England and Wales No. 2366937 Vat No. GB659 3720 08
SP Distribution plc, Registered Office: 1 Atlantic Quay, Glasgow, G2 8SP Registered in Scotland No. 189125 Vat No. GB 659 3720 08

We also welcome review of the incentive on costs for Black Start services. The recent Income Adjusting Event decision by Ofgem¹ to fund £54 million as an Income Adjusting Event (IAE) related to Black Start capability for 2016/17 by the SO in relation to the 2015-17 Electricity System Operator Incentives Scheme highlights that the existing market mechanisms available are inadequate to deliver the required services. The proposed changes in this area need to address the existing frameworks, such as transmission use of system charges (TNUoS) and the Capacity Mechanism, which do not appear to sufficiently incentivise generation with suitable technical characteristics that is able to meet black start requirements on a regional basis.

Answers to the consultation questions are provided in the attached appendix, but please do not hesitate to get in touch should you have require any further information on this response.

Yours sincerely,



Alan Kelly

Transmission Commercial and Policy Manager
Network Planning and Regulation
SP Transmission

¹ https://www.ofgem.gov.uk/system/files/docs/2016/08/decision_letter_iae_notice_17_08_2016final.pdf

Appendix 1: Response to Specific Questions

CHAPTER 2: Whether to maintain the existing incentives framework

Question 1a: Should we place financial incentives on the SO in the period between 1 April 2017 and when we are in a position to implement longer term SO incentives?

Although it is challenging to set effective targets for this incentive, the evidence presented in the consultation supports the view that the consumer is broadly benefiting from this scheme and so it is justified to continue with an incentive from April 2017 and beyond.

Question 1b: If we maintain financial incentives from April 2017 to spring/summer 2018, should we use the existing BSIS framework?

We agree the existing BSIS framework should be the basis for continuing until major reforms are identified and established, as we are not aware of any other better alternative.

Question 1c: Do you agree that if we maintain the existing incentives framework during this period, we should seek improvements from the 2015-17 scheme?

Yes improvements should be sought; in particular the introduction of a SO-TO incentive mechanism which will provide increased opportunities for the SO and TO to reduce overall outage costs for the consumer.

CHAPTER 3: Scope of potential changes from the 2015-17 scheme

Question 3a: How could the BSIS target setting approach and modelling methodologies be improved in the short term?

We are aware of the challenge to provide an accurate BSIS target figure based on the long term modelling (year ahead) approach. There are multiple factors associated with network outages that occur within year that impact overall constraint costs. For example, the uncertainty on forecasting wind generation, network faults, defects, and project overruns make a single target based on a modelling approach difficult. Applying a range and revising closer to real time might provide for more realistic BSIS targets in the short term.

Question 3b: Do you believe the existing BSIS sharing factor and cap and floor remain appropriate?

We consider the existing values to be reasonable.

Question 4: What is the best way to set an incentive on the SO to incur efficient costs when procuring Black Start from April 2017?

There is a clear need to secure access to generators to enable Black Start plans to be effective. We have highlighted previously² that there has been a material degradation in the restoration time for the SPT network since the closure of Longannet.

Black Start services are inherently locational in nature and any failure to contract with sufficient suitable generation in the north of England could have led to difficulty in enacting a restoration of the Scottish transmission system. A future incentive needs to consider regional risks such as this to ensure black start services are sufficient.

On this basis an ex-post assessment of costs would seem more effective than an up-front target setting approach which has led to a reactive approach to events that has not allowed time to ensure sufficient back start capabilities are in place. The expectation that existing black start stations may become permanently unavailable at relatively short notice requires alternative strategies to be developed in advance and a revised incentive must accommodate the transition to new generation technologies.

Question 5a: Do you agree that we shouldn't maintain the MDLC?

We agree that as a fundamental review is being conducted the MDLC is not required in the short term.

Question 5b: Do you agree that we shouldn't maintain the SO IRM? Are there any alternative ways to encourage innovative behaviour from the SO in the short term?

We agree that innovation schemes do need not be incentivised in the interim regime, unless there are projects in progress that could deliver benefits.

Question 6a: Do you believe there is a need for a new incentive on short term demand forecasts from April 2017? How could this be designed? What timescales should it be based on: week ahead, day-ahead, hour-ahead, other?

Demand forecasting is increasingly influenced by embedded generation. An incentive on the SO to improve the demand forecasting would lead to increased focus and development in this area which is appropriate given the impact embedded generation is now having on the operation of the transmission system.

We have already experienced this impact when planned outages on our network are cancelled at very short notice by the SO as a consequence of inaccurate forecasting of system conditions and demand. This has led to significant and costly delays to our major transmission upgrade works. The demand forecasting incentive needs to achieve consistency across each forecast period. The scope of the fundamental review of this incentive should consider how to capture embedded generation output to improve demand forecasting. This will need to involve distribution network operators as the SO does not have control of this area.

² https://www.ofgem.gov.uk/system/files/docs/2016/08/spt_response_to_consultation_on_nget_black_start_iae.pdf

Question 6b: Do you think there needs to be any changes to the wind generation forecasting incentive or new incentives on any other system forecasts?

We do not believe this incentive should change at this time as a short term forecast is the best that can be hoped to achieve, due to the unpredictability of wind conditions.

Question 7: Do you think the SO's procurement of balancing services needs to be more transparent and open? If so, what steps should be taken? Should the SO pursue more market-based approaches? Should we introduce any incentives or requirements on the SO in this area from April 2017?

Balancing services are complex and it would be helpful for the SO to address this going forward as alternative and innovative solutions for providing balancing services will be more able to be developed if the existing framework and mechanisms were more widely understood.

Question 8: Do you agree with our proposed scope of changes? Is there anything else you believe should be changed, added or removed from the existing scheme?

In general we agree that the proposed scope of changes looks appropriate for the incentives from 2017. However, it would be beneficial to understand the scope and timescales for the fundamental review and set a period for the interim arrangements on that basis rather than leave an open ended scheme in place.

Consultation on the SO-TO mechanism (Appendix 1)

Question 9: Do you agree that there is a need for a mechanism that allows the SO to exchange funds with the TOs? Are there any additional pros and cons that we should consider in our analysis? Do you agree it should be introduced from April 2017?

We agree there is a clear need for this type of mechanism. We identified the issue that upfront investment costs in major transmission projects are not currently able to be linked to the balancing services incentive mechanism. We engaged with Ofgem and the SO to identify a solution to this early in the RIIO-T1 period. More recently, we have been developing proposals in more detail with Ofgem, the SO and the other TOs under the governance of the Network Access Policy (NAP) industry working group. This development work is largely reflected in the consultation proposals.

It is important to understand that as a TO, we develop an efficient, co-ordinated and economic system but at this time the BSIS mechanism cannot be used to fund upfront capital investment costs from potential constraints savings achieved.

For example, an offline substation build could significantly reduce outage costs but require additional land purchase costs. Our existing funding arrangements drives us to select the most economic option based on upfront design and delivery costs, thereby minimising costs to consumers. The current BSIS mechanism cannot factor in this type of cost saving as it sets the incentive target based on a year ahead outage plan. Different costs

associated with alternative design and build solutions are not able to be factored in to the year ahead outage plan. The potential overall constraint cost savings for alternative designs can only be modelled well in advance and are not certain to materialise and therefore net cost savings may not materialise for consumers. A longer incentive period may be able to accommodate different design solutions into the target setting calculation.

The current proposals in this consultation do not resolve this issue in full. However, they do achieve some benefit by accommodating short term measures that a TO can take to extend or move outages to reduce constraint costs following finalisation of the year ahead outage plan and setting of the BSIS target. Specifically, these types of service are covered in paragraph 34 of Appendix 1 and involve moving and compression of outages. It is possible the arrangements to affect these changes can be implemented by April 2017. However, full implementation of the arrangements may take more time as industry codes, such as the STC, will require to be amended.

The proposals to introduce more significant measures such as installing temporary by-pass arrangements and introduction of new assets in the system covered by paragraphs 35 and 36 will not be able to be implemented using the current BSIS mechanism for the reason explained above. These proposals will need to be developed in the more fundamental review of this mechanism proposed or within preparations for the next price control period.

Question 10: Do you agree with the codified-approach?

The codified approach presents the most effective mechanism to achieve the short term solutions that are possible in the existing BSIS framework.

Question 11: What do you consider to be the most appropriate cost recovery levy methodology?

We consider the approach to spread the levy at a flat rate across all settlement periods in the year is the most simple and appropriate to apply.

Question 12: Do you agree with the proposed approach with regard to the financial aspects of the mechanism outlined above?

Yes we support this approach.

Question 13: Do you agree with our proposed investment threshold for Ofgem approval?

We consider the £1.4 million is an appropriate starting point and will accommodate a reasonable volume of short term mitigating actions.

Question 14: Do you think the costs incurred through a mechanism should be incentivised as part of an overarching financial target on balancing costs, or as part of a separate financial incentive?

We consider there are sufficient obligations on the SO and TOs to ensure a focus and behaviours to minimise constraint costs and deliver efficient services. No new incentive should be required. The changes being implemented by the TO year ahead or within year under this SO – TO funding arrangement will impact the constraint cost out turned against the agreed yearly target.

Question 15: What, if any, impact will limiting the mechanism to the end of RIIO-T1 period have on the efficiency of potential projects that cover both RIIO-T1 and RIIO-T2 periods?

We would expect a similar mechanism to be established for the RIIO-T2 period, and the short term proposals likely to be established in April 2017 should be enduring.

Question 16: Are there any other criteria we should consider for such projects?

The medium and longer term services that could be provided by TOs should be identified within the more fundamental review and RIIO-T2 investment plan negotiations.

Question 17: What level of transparency would you want regarding this mechanism?

We would expect to be able to demonstrate the activity and value of constraint savings being delivered through this mechanism

Question 18: Do you consider that we have identified the changes required correctly? Are there any other changes required to the existing framework in order to implement the mechanism?

The changes required will deliver a mechanism to enable the TO to establish short to medium term services that will mitigate constraint costs. An alternative mechanism needs to be considered that provides a means to link long term solutions. We would expect this to be part of the development of our RIIO-T2 investment plans

Question 19: Are there any other factors that you think we need to consider in the design of the mechanism?

There may be opportunity to allow generators or other third parties to fund the additional services a TO could provide in addition to these consultation proposals which provide for the SO to fund costs. This type of request has been made to us by customers in the past, but there is not a mechanism in place currently to facilitate such a proposal.

The consultation proposals seek to bring benefits to GB consumers as a whole, by netting off the cost of additional TO services in respect of network outages, against reductions in overall constraint costs. However, there are network outages that do not necessarily incur high constraint costs but materially impact a single or several connected parties. With the proposed arrangements the additional costs in this scenario would not qualify for funding. It would be worthwhile reviewing the proposals to consider if this type of situation could also be included in the design of the funding mechanism.