



David Beaumont  
System Balancing  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Head Office  
Inveralmond House  
200 Dunkeld Road  
Perth  
PH1 3AQ

[polina.kharchenko@sse.com](mailto:polina.kharchenko@sse.com)  
01738 512072

15 September 2016

Dear David,

#### **Electricity System Operator incentives from April 2017**

SSE welcomes the opportunity to respond to Ofgem's consultation on electricity SO incentives for the interim period from April 2017. Our comments to specific consultation questions in relation to the BSIS framework are outlined further in this document.

We also provide our views on the SO-TO mechanism in Appendix 1.

Separately, we would like to emphasise the importance of the fundamental SO incentives review and are looking forward to Ofgem's consultation on this later this year.

Kind regards,

**Polina Kharchenko**

Regulation Manager

### Consultation Questions

**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?**

We consider that maintaining the existing SO incentives framework whilst introducing enhancements in a number of areas is a preferable way forward in the interim period from 1 April 2017 to spring/summer 2018. Setting the up front clearly defined incentives for this period should provide certainty to industry participants, consumers and NGET.

We would also like to emphasise the importance of the fundamental BSIS review and expect that Ofgem will be in a position to conduct this review and implement the required changes to the scheme in spring/summer 2018 without further delay.

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

As outlined in our response to Q.1a, we consider that it is appropriate to use the existing BSIS framework for the interim period from April 2017 to spring/summer 2018 whilst making enhancements in certain areas.

**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? Please provide evidence to support your answers.**

We believe that improvements to the scheme should be sought wherever possible within the given timeframe.

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

We agree that giving the SO more ability to rectify modelling issues over the course of the interim BSIS would deliver some benefits in the short term. Any modelling issues resulting in a meaningful impact on modelling outputs should be agreed with Ofgem and made public.

Separately, our views on how the costs incurred through a SO-TO mechanism could be incentivised are outlined in our response to Question 14. While we do not propose making upfront changes to the constraint costs target setting, the methodology would need to be amended to reflect how the real or estimated system cost savings achieved through the SO-TO mechanism will be taken off the constraints cost target at the end of the incentive period to avoid incentivising NGET twice for the same action.

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

We note considerations raised through the CMP267 workgroup, including the option of inflating the cap and setting a monetary number as a threshold limit instead of the percentage level. We believe the existing 30% sharing factor and the £30m cap and floor remain appropriate in the interim period.

We propose that the sharing factor and cap and floor level are revisited as part of the fundamental SO incentives review.

**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?**

Given the recent Black Start (BS) Income Adjusting Event (IAE) notice raised by NGET, it is apparent that historic levels of expenditure in legacy BS contracts are unlikely to be representative of future costs. Whilst alternative longer term BS strategies are progressed by NGET, in the medium term there will be a need to continue to contract legacy services from existing plant by extending the contract terms with those providers. The economics of the plant capable of providing BS services remains challenging and this should be taken into account while considering how the BS cost target is set.

In our view, until a fundamental review of the Black Start procurement framework is conducted, it is more appropriate to assess Black Start costs incurred by NGET on the ex-post basis in the interim period.

**Question 5a: Do you agree that we shouldn't maintain the Model Development Licence Condition (MDLC)?**

We support the proposal that the MDLC should not be maintained in the interim period. The incentive to develop enduring longer term models should be subject to a fundamental review later this year so that the nature, accuracy and time horizon of these models are adequately scrutinised.

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

We support the view that Ofgem should not maintain the SO IRM. While we are supportive of networks innovation in principle, we believe that the current level of governance around the SO IRM does not result in NGET delivering plausible innovation solutions for the market.

For example, only limited feedback on the progress of NGET's innovation projects is shared with the industry. In 2014 NGET received £12.6m for two innovative projects through Ofgem's Network Innovation Competition, including £5.7m for the gas robotic inspection

project and £6.9m for the Enhanced Frequency Control Capability (EFCC) project. There has been no update since then on the development of these projects and the benefits they have delivered for the environment and consumers.

**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?**

The level of demand on the transmission system is a direct input to NGET's BSIS models and is a key driver for frequency response and constraint costs. NGET should be incentivised to produce accurate demand forecasts so that the BSIS constraint cost targets it sets for itself are accurate and incentivising.

A financial incentive on the SO to produce accurate day-ahead demand forecasts will be especially important with embedded generation increased running hours (which the market has a limited sight of) and a rise in smart meters and demand side flexibility solutions (with the SO ability to influence demand becoming increasingly important). Accurate demand forecasts would also result in more efficient trading and despatch decisions by market participants.

In our view, a demand forecasting incentive structure similar to the wind generation forecasting incentive is a workable solution. Ofgem's proposal to measure average forecasting errors at more granular intervals and impose financial penalties on the SO should they exceed certain maximum error bands in any week or day should encourage the SO to produce more accurate demand forecasts and BSIS modelling outputs.

**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?**

In our view, wind generation forecasting is currently based on a simplified methodology. NGET is only using wind speed predictions, combined with data on the characteristics of wind turbines to calculate a predicted output of each wind generation BM Unit and then aggregates individual predictions at a national level for each Settlement Period.

The NGET's wind generation forecast should account for the curtailment actions NGET reasonably expects to take based on its view of generation availability, demand forecast and balancing options available at its disposal.

**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?**

We support the view that the SO's procurement of balancing services needs to be more transparent and open. NGET in its role of the SO is privy to the information which has a direct impact on imbalance prices and hence this information should be made available to the market. This includes information on system constraints, ancillary services contracts and other balancing tools such as Power Exchange Trades, Forward Energy Trades and Energy Balancing Contracts. We recommend that all significant transactions which the SO is a party to should be made available to the market under similar timescales to those published on BM Reports webpage.

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

In our view the scope of Ofgem's proposed changes is appropriate for the interim period, subject to the additions specified below.

We believe that the way NGET is currently managing access to short-term Transmission access products is not fit for purpose and should be improved before April 2017. Specifically, the application process to secure TEC access products, such as Short Term TEC, Limited Duration TEC and TEC Transfer is unduly slow and cumbersome and does not fit the dynamics of the current energy market or the future capacity market. A complete overhaul of the short-term Transmission access framework is also required to develop new weekly or daily Transmission access products so that generators are able to provide balancing and ancillary services when they are most required by the system.

In addition, we believe that pumped storage is currently not optimally utilised as a balancing tool at the time of system surplus. In our view, pumped storage utilisation at the times of oversupply is a more cost effective action compared to wind curtailment and would result in lower BSUoS. NGET should be incentivised to utilise the most cost effective tools available at its disposal to correct the energy imbalance differences.

Separately, our views on the proposed TO-SO mechanism are outlined further in Appendix 1.

## **APPENDIX 1 – Consultation on SO-TO mechanism**

**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?**

In our view, the existing STCP 11-3 mechanism, which already allows the SO to exchange funds with the TOs through excluded services, is a useful tool to support the SO function of ensuring system security and reliability. It allows the SO to manage changes in the TOs' planned outages, when security reasons indicate that this is necessary, at the same time that it allows the TOs to recover the extra costs incurred in order to re-arrange the outage works. Building on this mechanism, we believe that the proposed new mechanism is a useful additional tool for the SO to drive system cost savings.

Beyond the pros and cons identified in the consultation, we believe that notifying the stakeholders affected by the outage change (such as generators and industrial companies) with a short notice could, occasionally, cause some problems or losses to them. Therefore, we believe that the new mechanism should find a balance between the flexibility required to achieve system cost savings and the minimum firmness and anticipation required for those stakeholders.

Furthermore, we would like to highlight that, to guarantee that this mechanism delivers system savings and ultimately benefit to customers, it is important that it is designed in a way that assures that the system cost savings are greater than the extra cost of reallocating the outages.

We support the proposal to introduce it from April 2017, if the required detailed processes can be developed and agreed with the stakeholders in time, and the appropriate funding mechanism is put in place. We believe that the utilisation of the new mechanism in the next year will provide valuable learning experience for all stakeholders involved, which could be useful to inform the next SO incentives framework to be implemented from 2018.

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

We believe that the application of a codified-approach is more appropriate than the contractual approach for the following reasons:

- a. Considering that this approach has been used and validated through the current STC 11-3 procedure, it will be easier to understand, agree and implement by the TOs and SO.
- b. The process is less time consuming, aligned with the need to manage the outage changes, and at the same time, it guarantees that the mechanism will be triggered in reasonable notice period, reducing the risk for the TOs.

- c. A codified approach reduces the prospect for potential conflicts and disputes between SO and TOs.

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

We believe that the cost of the TO funding should be recovered through BSUoS as cost savings achieved through this mechanism will offset other balancing services costs. Cost recovery over the period in which constraints savings are realised seems to be the most appropriate way forward.

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

We support the financial mechanism principles described in point 38 (page 31) of the consultation. Furthermore, we also agree that the utilisation of excluded services is the proper mechanism to exchange funds between SO and TO, as it allows the TOs to recover their extra costs, without any return/incentive on those amounts.

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

We agree with the set up of thresholds for investments exceeding a certain level. The threshold should be adequate to allow a quick decision process and at the same time to keep control and transparency over the amount expended. In our view, it would be appropriate to have two thresholds for Ofgem approval:

1. One for the total pot of money. The SO should require Ofgem approval when it exceeds the proposed £1.4m pot of money in the year.
2. Another threshold for individual projects, i.e. Ofgem would need to sign-off when a project exceeds a predetermined level of costs. In our view, £200,000 would be a recommendable threshold, as most of the average extra costs to change an outage should not surpass this amount.

**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?**

A separate financial incentive can provide more control and transparency, but it would require that the target of the overall spend on balancing services is decreased to avoid SO receive double incentives over the same action.

If this is the case, we would recommend setting up a constraint cost target using the existing methodology (without considering the potential saving of the new mechanism), and, at the

end of the period to be accrued, take out of the target the real or estimated system savings obtained through the new mechanism. Also, a separate incentive could be created, specific to the new mechanism, designed to share a proportion of the system cost savings accrued with the SO.

**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?**

Theoretically, if the SO knows that the mechanism will not be available from RIIO-T2, there could be an incentive to anticipate potential RIIO-T2 planned outages for RIIO-T1 period, and therefore create more opportunities to use the mechanism. In practical terms, we do not see this behaviour as feasible, as the planned outages are determined together between TO and SO, attending TO's criteria to assure that the project delivery will be on time.

Beyond that we believe that, up to the moment of the transition between RIIO-T1 and RIIO-T2 periods, the industry will have enough information about the effectiveness of the new mechanism and Ofgem will be able to make the best decision about keeping, modifying or removing it.

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

We did not identify any other criteria.

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

As with all services impacting the system costs, we expect transparency in the whole process, from the trigger criteria to the settlement process, but especially on the savings obtained and on the methodology to recover the cost from market participants. Transparency about TO extra cost recovery through this mechanism is also needed, and we think the current process used for STC 11-3 combined with the thresholds for Ofgem approval give an adequate level of transparency. In any case, the levels of disclosure of the TOs' costs should be agreed before implementation, to avoid revealing sensitive commercial information.

**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?**

We did not identify any other changes required to the existing framework.

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





In our view, estimating the system cost savings could be challenging, as highlighted by Ofgem in the consultation, but it is crucial to assess efficiency and net benefit of this mechanism.

Separately, as part of the fundamental SO incentives review it might be beneficial to consider a scenario where constraints only impact a single or several generators. In such scenario it might be useful to consider how those generators can participate in the TO funding mechanism.