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Dear Leonardo,

### **Initial Proposals for electricity System Operator incentives from April 2017**

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

#### **The proposals for the interim System Operator incentive scheme are positive**

We support steps to increase the effectiveness of the BSIS scheme such as the improvement of the target-setting models, the reduction of the sharing factor and the removal of Black Start costs from mechanism. The changes to the incentive governance arrangements aimed at increasing stakeholders' confidence in the target setting models are appropriate, especially in light of the material impact of the errors identified on both the target and performance against the incentive during the current scheme.

We also support the introduction of licence obligations to increase the transparency and openness of procurement of balancing services. NGET's current approach to procurement may have contributed to suboptimal outcomes and may distort price signals<sup>1</sup>, which could lead to higher costs to consumers than necessary. The adoption of market-based approaches to the procurement of balancing services, where appropriate, should deliver better value of money for consumers.

#### **Impact of identified errors on past incentive schemes should be clarified**

The errors identified relating to the BSIS target have had a material impact. There is also a commitment to progress further work to identify other errors ahead of the implementation of the interim scheme. We believe Ofgem should clarify whether any of the errors identified affect past incentive schemes. We note the March 2016 decision<sup>2</sup>, which allows "*...adjustments to the system operator external costs incentive scheme that may arise from*

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<sup>1</sup> Future arrangements for the electricity system operator: its role and structure, paragraph 2.34 (<https://www.ofgem.gov.uk/publications-and-updates/future-arrangements-electricity-system-operator-its-role-and-structure>)

<sup>2</sup> Decision on the Modification of National Grid Electricity Transmission Plc's Electricity Transmission Licence - Updating Incentive Performance in Past Incentive Schemes (<https://www.ofgem.gov.uk/publications-and-updates/decision-modification-national-grid-electricity-transmission-plc-s-electricity-transmission-licence-updating-incentive-performance-past-incentive-schemes>)

*model or data errors in the previous six years in some circumstances...*". In particular, that decision allows performance against past schemes to be updated (under Special Condition 4C) if errors were caused by NGET and would benefit consumers. If any of the errors fall within the scope of Special Condition 4C the necessary downwards adjustments should be made.

We hope you find these comments helpful. Answers to the consultation questions are attached. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning  
Head of Network Regulation, Forecasting and Settlements

## **Answers to consultation questions:**

**CHAPTER: Two Question 1: Do you agree with our proposals to introduce new licence requirements / guidance around SO balancing behaviour? Please explain your answer.**

**CHAPTER: Two Question 2: Do you agree with the clarifications we propose to introduce to NGET's licence? Is there anything missing or that should be removed? Please explain your answer.**

The proposals to introduce new licence requirements / guidance around SO balancing behaviour and the proposed clarifications seem sensible. We support the explicit statement of the expectations on NGET to consider a 'whole system' approach to its decision-making and take the most efficient actions to balance the system and address system issues. We also support the explicit requirement on NGET to take into account the impact its actions have on competition in the electricity market and on the wider system efficiency.

**CHAPTER: Two Question 3: Do you agree with our Initial Proposal of maintaining a model-based target from April 2017 until March 2018? Please explain your answer.**

We agree that a model-based target for the interim scheme should be maintained.

**CHAPTER: Two Question 4: Do you agree with our proposed changes to the governance and incentive parameters? Is there anything missing or that should be removed? Please explain your answer.**

We agree reducing the cap and floor to +/- £10m is a means of mitigating windfall gains or losses. In order to provide an effective incentive, however, a range is required for the cap and floor which is likely to keep outturn performance within the incentivised range in most circumstances. We cannot assess whether, with the corrections made to the models, £100m will achieve this and we recommend this is kept under review for the enduring scheme.

We also request Ofgem clarify whether any of the errors identified fall within the scope of Special Condition 4C.

**CHAPTER Three Question 1: Do you agree with our proposal to remove Black Start from BSIS? Please explain your answer.**

Yes. Recent events such as the 2015-17 mid-scheme update of the Black Start target and the 2016 Income Adjusting Event highlight the difficulty in setting an appropriate target. Uncertainty surrounding the impact of the Capacity Market on Black Start capability will also make an ex-ante target difficult.

**CHAPTER Four Question 1: Do you agree with our amended wind generation forecast incentive proposal? Are there any elements you feel should be changed or that are more relevant to you? Please explain your answer.**

**CHAPTER Four Question 2: Do you agree with our proposal to introduce demand forecasting incentives in this interim scheme? Are there any elements you feel should be changed or that is more relevant to you? Please explain your answer.**

We agree with the proposals relating to the wind generation and demand forecasting incentives because it is unlikely balancing actions and costs will be as efficient as can be without sufficient understanding of influencing factors such as volumes of intermittent and embedded generation. Further, without sufficient understanding of these factors, the SO may unintentionally provide inappropriate signals and distort the markets for balancing and ancillary services.

**CHAPTER Four Question 5: Do you believe we should introduce an additional mechanism to counter the incentive to under or over-forecast in any given month to maximise incentive value? Please explain your answer.**

This proposal seems sensible given concerns about the asymmetry of forecast errors.

**CHAPTER Five Question 1: Do you agree with our proposal to introduce a mechanism for the SO-TO to exchange funds? Please explain your answer.**

**CHAPTER Five Question 2: Do you agree with our proposal to introduce a pilot SO-TO incentive? Do you agree with the structure proposed? Is there anything missing or that should be removed? Please explain your answer.**

We agree greater coordination between the SO and TOs and allowing the SO to fund TOs to undertake certain works may reduce overall system costs. We agree that only projects which have not been funded as part of other schemes or mechanisms should be considered. However, we also believe that the TO should not be able to substitute the work funded by the SO for outputs it has been funded to deliver.

**CHAPTER Five Question 3: Do you agree with our proposal to introduce a requirement for a quarterly report? Is there anything missing or that should be removed? Please explain your answer.**

Yes. Quarterly reports should provide greater transparency to the industry and allow stakeholders to assess whether NGET's actions are of benefit to consumers.

**CHAPTER Six Question 2: Do you agree with our proposal to not introduce a financial incentive on transparency? Please explain your answer.**

Our expectation is that National Grid should always be seeking to be open and transparent with respect to its balancing services procurement and should always be seeking market based solutions. We agree these are things that NGET should do as part of its baseline behaviour and should not be rewarded for.

**CHAPTER Six Question 3: Do you agree with our proposal to retain the MDLC? If not, please explain your answer.**

**CHAPTER Six Question 4: Do you agree that we should amend the MDLC to require NGET to get third party scrutiny on areas where the model could be improved? Please explain your answer.**

We agree the MDLC should be retained. Improvements in short term demand forecasting might affect balancing actions carried out by the SO and any improvements should also be captured in the target setting models so that genuine efficiencies may be measured. Additionally, continued model development can support rather than conflict with the fundamental review of the SO incentive scheme.

**CHAPTER Six Question 5: Do you agree with our proposal to discontinue the System Operator Innovation Roll-Out Mechanism? Please explain your answer.**

We agree with the proposal to discontinue the SO IRM for a short term scheme. If the BSIS scheme is effective in giving incentives to reduce costs, this will also drive innovation and there is no need for a separate incentive.