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31 January 2017

Dear Leonardo,

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

Thank you for the opportunity to provide views on behalf of ScottishPower on Ofgem's consultation on its Initial Proposals for Electricity System Operator incentives from April 2017.

We welcome the overall package of proposals which we believe are likely to result in more efficient system costs for the benefit of consumers and a boost for investor confidence.

Ofgem's proposal to amend licence condition C16 and issue guidance around NGET's baseline balancing behaviour will clarify the high standards which are rightly expected of the SO in managing the network and will be beneficial in setting expectations for all market participants. Clarifying Ofgem's detailed expectations will also make it easier for Ofgem to consider enforcement action should performance fall below the specified standards; this should be beneficial for investor confidence.

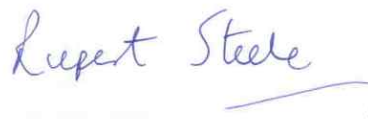
We welcome Ofgem's proposal to remove Black Start from BSIS and remove the target-based approach to incentivisation for 2017/18. The costs incurred by the SO in relation to a forecast target are unlikely to represent an indicator of efficient or inefficient behaviour given the set of circumstances that will be faced in GB over this period. We support its replacement with an alternative approach whereby Ofgem decides whether to allow or disallow costs based on how well NGET has complied with its approved strategy and procurement methodology over the year.

We believe the package of proposals will enhance transparency and is a comprehensive response to the issues raised by market participants. We agree that a financial incentive on transparency is not necessary as it should be a fundamental expectation of the SO. In introducing the proposed 'balancing principles' guidance in the C16 licence condition there is sufficient incentive for the SO to behave in a manner which maximises transparency in its procurement activities.

We welcome Ofgem's proposal to introduce a mechanism for the SO-TO to exchange funds as we believe that this principle will facilitate more efficient outcomes for consumers in circumstances where coordination between the SO and relevant TO could result in a reduction in overall system costs.

I hope you find these comments useful. Should you wish to discuss any of these points further then please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in blue ink that reads "Rupert Steele". The signature is written in a cursive style and is underlined with a single horizontal stroke.

**Rupert Steele**  
Director of Regulation

**ELECTRICITY SYSTEM OPERATOR INCENTIVES FROM APRIL 2017 –  
SCOTTISHPOWER RESPONSE**

**Chapter 2: Balancing cost incentives**

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

We support Ofgem's proposal to amend licence condition C16 and issue guidance around NGET's baseline balancing behaviour. This will clarify the high standards which are rightly expected of the SO in managing the network and will be beneficial in setting expectations for all market participants – which should result in more efficient system costs

Clarifying Ofgem's detailed expectations will also make it easier for Ofgem to consider enforcement action should performance fall below the specified standards; this should be beneficial for investor confidence.

**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.**

We support the clarifications which Ofgem proposes to introduce to the NGET's licence condition C16 and consider that they are a comprehensive package of principles which will benefit competition and therefore consumers.

**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.**

In our response to Ofgem's SO Incentive Scheme consultation dated 15 September 2016, we indicated that we broadly supported maintaining the existing framework subject to any quick wins, ahead of the implementation of the recommendations of Ofgem's wider review in spring/summer 2018. For this reason, we support in principle the retention of the model-based target during 2017/18.

However, we note the concern stated by Ofgem that the model's performance was "not fit for purpose" and that it has "reduced confidence" that it will be possible to generate an appropriate target for 2017/18 – this is an alarming development. In the short term we welcome the re-assurance that Ofgem's governance proposals should resolve this issue.

However, in the longer term, and with an eye on the wider review of SO incentives being undertaken by Ofgem for implementation in 2018, we would be open to consideration of the replacement of complex SO incentive schemes with principles-based licence obligations, provided they are backed up by a meaningful enforcement appetite.

**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 support the proposed changes to the governance and incentive parameters.

### **Chapter 3: Black Start**

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

We welcome Ofgem's proposal to remove Black Start from BSIS and remove the target-based approach to incentivisation for 2017/18; the costs incurred by the SO in relation to a forecast target are unlikely to represent an indicator of efficient or inefficient behaviour given the set of circumstances that will be faced in GB over this period.

Historically, black start costs have reflected incremental costs faced by ageing plants which have since retired due to a lack of profitability. In the medium term, we would expect black start costs to rise to a somewhat higher level, sufficient to attract investment in new capacity. Such new capacity will look to black start revenues, in combination with other stacked revenues (eg from capacity and energy markets) to recover long run marginal costs.

However, in the intervening period which includes 2017/18, as a result of an appropriate strategy not being in place to mitigate the closure of ageing black start providers and bring forward new entrants, it is likely that higher costs will be incurred which are reflective of the marginal costs of retaining existing service providers - as was demonstrated by the £113m costs incurred by the SO in contracting with operators of the Drax and Fiddler's Ferry coal-fired plants in 2016/17.

In our opinion it would therefore not be appropriate to retain a Black Start incentive during 2017/18 which could result in windfall gains or losses. We support its replacement with an alternative approach whereby Ofgem decides whether to allow or disallow costs based on how well NGET has complied with its approved strategy and procurement methodology over the year.

**Question 2: Do you agree with the principles of our Black Start regulation? Should we add or remove any principle? Please explain your answer.**

Ofgem's high level principle for black start regulation is to ensure that NGET can make decisions that allow the optimal level of black start provision at the lowest possible cost to consumers, taking into account an accurate cost benefit assessment of trade-offs between consumer preferences for cost and security. We agree that this principle is appropriate and we also agree with the list of supporting objectives set out in Table 1.

It would be helpful for Ofgem to confirm whether it intends that these regulatory objectives will be covered by the 'balancing principles' amendments and associated guidance for licence condition C16 or whether additional licence modifications will be required.

**Question 3: Do you agree with our proposed regulatory framework for 2017/18? Please explain your answer.**

The framework proposed by Ofgem is an appropriate and comprehensive response which should ensure delivery of black start objectives in a manner consistent with consumers' expectations.

#### **Chapter 4: Forecasting incentives**

**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.**

We agree that the proposed measures appear to be sensible and would encourage a review of wind generation forecast performance closer to half-hourly forecasts. It is important in the first instance, as noted in paragraph 4.39, that BOAs are not erroneously excluded from the comparison of forecasts versus actuals.

**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 that the proposed measures appear to be sensible.

**Question 3: Do you have any additional criteria that you would propose for the Quarterly Forecast Report? Please explain your answer.**

We welcome the introduction of the Quarterly Forecasting Report and the measures proposed for inclusion.

**Question 4: Do you agree with how the parameters for the incentives are calculated? Should we consider anything else when setting the target?**

We are broadly supportive of how the parameters for the incentives are calculated.

**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.**

We are satisfied that the proposals are appropriate and that no additional mechanism is required, but we recognise that market participants, and ultimately therefore consumers, face the costs of such forecasting errors in each half-hour settlement period.

#### **Chapter 5: SO-TO mechanism**

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

We welcome Ofgem's proposal to introduce a mechanism for the SO-TO to exchange funds as we believe that this principle will facilitate more efficient outcomes for consumers in circumstances where coordination between the SO and relevant TO could result in a reduction in overall system costs.

**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 with the proposal to introduce a pilot SO-TO mechanism and consider the proposals to be a good starting point. We would note, however, that the pot limit of £1.4m may restrict opportunities for larger schemes where significant benefits are more likely to be realised. We would therefore encourage Ofgem to ensure that the minimum criteria proposed in paragraph 5.21 and the process surrounding them are as streamlined as possible, so that such opportunities are not made difficult or lost due to resourcing constraints or delayed decision making.

In addition, we would encourage Ofgem to consider opportunities where developers could contribute to TO works. For example, a generator may be willing to contribute towards additional resource costs needed to shorten an outage, if as a result it can reduce lost output caused through downtime. There is currently no contractual ability for this to take place and opportunities have been identified in the past which could otherwise have been realised.

**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.**

We agree with the proposal to introduce a requirement for a Quarterly Forecast Report and the measures proposed for inclusion.

## **Chapter 6: Transparency, Model Development and Innovation**

**Question 1: Do you agree that the proposed changes describe in Chapter 2 will enhance transparency? Please explain your answer.**

We are satisfied that the package of proposals described in Chapter 2 will enhance transparency and that it is a comprehensive response to the issues raised by market participants in response to the consultation published on 4 August 2016.

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

We agree that a financial incentive on transparency is not necessary as it should be a fundamental necessity expected of the SO. In introducing the proposed 'balancing principles' guidance in the C16 licence condition there is sufficient incentive for the SO to behave in a manner which maximises transparency in its procurement activities.

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

We previously indicated that we thought it would be inappropriate to maintain the MDLC requirement in light of the longer term review of the BSIS scheme which would be expected to no longer use these models. However, in the context of the models being used during 2017/18 and the concerns which Ofgem has raised regarding their appropriateness, we agree that there may be merit in retaining the MDLC for a further year.

**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.**

Yes, third party scrutiny would be appropriate against the context of the concerns which Ofgem has raised.

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

We agree that it would be inappropriate to maintain the SO Innovation Rollout Mechanism (IRM) facility in light of the limited duration of the 2017/18 incentive scheme. However, in the longer term we believe it is an important incentive for innovation and we assume it will be replaced by a successor scheme commencing in spring/summer 2018, reflecting Ofgem's wider review of the SO incentive scheme. Unlike the Network Innovation Allowance or Network Innovation Competition, it allows the roll out a proven innovative solution at a larger scale.

ScottishPower  
January 2017