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Dear Leonardo,

**Initial Proposals for electricity SO incentives from April 2017**

Thank you for an opportunity to provide comments on the initial proposals for electricity SO incentives from April 2017.

We welcome Ofgem's proposals to improve governance and transparency around BSIS models for 2017/18 and to introduce additional incentives on the SO to produce accurate forecasts. We also welcome the proposal to amend the SO's licence to make it clearer what Ofgem expects of NGET's baseline balancing behaviour as part of its economic and efficient obligation under the transmission licence.

Our views to the consultation questions are provided further in this document.

Kind regards,

Polina Kharchenko

Regulation Manager

## Consultation Questions

### 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.**

Yes, we agree. New licence requirements and further Ofgem guidance should incentivise the SO to focus on wider and longer-term implications of its balancing actions and, therefore, would result in more economic and efficient balancing actions taken by the SO. New license requirements, as outlined in Box 1 of the consultation, are also more in line with the future role of the SO and the principles outlined by Ofgem in the consultation on the future arrangements for the SO.

**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 agree with the clarifications to Condition C16 of the NGET's transmission licence. In our view the list of additions is comprehensive.

**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.**

Yes, we think that a model-based incentive target approach combined with a more transparent and robust governance process is a practical solution for the interim period. Even though models and methodologies will need to be reviewed and adapted to reflect the outcome of the fundamental SO incentives review, other schemes considered by Ofgem for the interim period would either be more resource-intensive (e.g. cost disallowance mechanism or discretionary reward process) or could have unintended consequences for consumers (e.g. in the case of no incentive scheme).

**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.**

On balance, we support the proposed changes. We welcome Ofgem's proposal to formalise the process for identifying and correcting model errors and a suggestion to put the incentive scheme on hold until those errors are rectified. This should ensure that any modelling issues are identified in time and fixed as a matter of priority. We also agree that a third party ex-ante and ex-post audit of BSIS models should be introduced to provide additional assurance. It seems, however, that an increased focus on ongoing reporting and checks throughout the interim BSIS implies that the current models remain unreliable. We, therefore, support a reduction of the cap and floor and the sharing factor to +/-£10m and 10%, respectively, as this should limit the SO's windfalls gains and losses caused by any model inaccuracies.

## **Black Start**

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

In our view it is appropriate to remove Black Start costs from the BSIS while a fundamental review of the Black Start procurement framework is ongoing. Given the recent Black Start Income Adjusting Event notice raised by NGET, it is apparent that any modelling on the basis of historic Black Start costs to produce an ex ante cost target is unlikely to produce robust results.

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

We agree that Black Start regulation should seek to ensure that the adequate level of Black Start service provision is achieved at the lowest possible cost to consumers. Given the changing market dynamics, the approach to setting Black Start targets and the Black Start procurement process will need to be changed accordingly.

In our view, a principles-based approach proposed by Ofgem introduces sufficient flexibility to the Black Start service procurement process. This approach should allow NGET to enhance Black Start procurement while developing a longer term view of capabilities and alternatives in the Black Start market.

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

It is not clear whether there is sufficient time for the SO to produce a robust Black Start strategy before the start of the incentive year against which the SO's performance would be assessed at the end of the incentive year. In principle, however, we welcome a re-introduction of the BS strategy and procurement methodology in the incentive scheme.

We agree that a report would need to be produced by the SO at the end of the year explaining the steps the SO has undertaken to ensure that Black Start has been procured economically and efficiently. We also support efficiency checks and any other tests Ofgem chooses to undertake to ensure that any non-compliant costs are disallowed.

## **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 with the proposed amendments to the existing day-ahead wind generation forecasts incentive. We support a split of the cap/floor between seasons and unbiased forecasts with winter having a larger weighting reflective of wind volatility and importance of reliable wind output forecasts in winter months. We also think that measuring average

forecasting errors on the basis of the SO's half-hourly forecasts should encourage the SO to produce more accurate outputs. In our view, a monthly cap which Ofgem proposes to introduce will limit the SO's gain or loss in any particular month without discouraging the SO to continue focusing on producing robust projections in subsequent months.

We agree that the percentage error targets for wind generation forecasting should remain unchanged at 3% and 4.75% for summer and winter, respectively. The SO is yet to show an improvement in its average forecasting errors against these targets.

**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 welcome the proposal to introduce incentives at the day-ahead, two-days ahead and week-ahead demand forecasts. Taking into account the importance of robust demand forecasts for the market and that the SO already produces these forecasts for its own use, any percentage error targets introduced for these incentives should challenge and encourage NGET to use all its tools and the whole system view to produce robust demand projections.

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

We do not propose including additional criteria in the report. We would suggest that the report is published in a spreadsheet format with commentary and explanations available in the relevant sections.

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

Yes, we support the methodology.

**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.**

The monthly scheme parameters could be trialled in the interim scheme to test the effectiveness of this approach.

### 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.**

Yes, we agree with the proposal as this gives the SO an additional mechanism to make potential operational cost savings which will largely be passed on to the consumer. The current STCP 11.3 only allows the SO to pay the TO for outage changes if there are system security issues.

**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.**

Yes, we agree with the proposals in the current format, however, it is not clear how the benefits will be measured – a transparent approach is required taking into account all potential costs and benefits, including costs to generators receiving late notice of changes to planned outages.

**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.**

It is not made clear that the estimated consumer benefit and cost savings will be included in the report but this should certainly be a key part of any report published. We would also wish it to be made clear in the reports that the TOs are not being incentivised, or rewarded, for these outage changes, it is only our attributable change costs that are being passed on.

### 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.**

Yes, we agree. We welcome improved governance of the BSIS models as this would improve accuracy of the models and would provide more reliable information and data to market participants. We also support an amendment of the NGET's licence Condition 16 which should clarify expectations on the SO and encourage a more efficient balancing behaviour.

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

Yes, transparency should be a baseline feature of the wholesale energy market and improvements in transparency and information symmetry should be not incentivised financially but imposed as a mandatory requirement.

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

We support the proposal to retain the MDLC. The models will clearly need to be reviewed and adapted to ensure that they reflect the outcome of the SO incentives fundamental review; however a continuous development of these models in the meantime could provide a better basis for any further discussions on how these models should be improved in the future.

**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.**

In our view requiring third party scrutiny on certain areas of the models is a useful amendment to the licence condition. This should further reinforce governance around the BSIS and ensure that the models continue to be fit for purpose.

**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. We expect that a more effective mechanism, if necessary, can be developed as part of the fundamental review of SO incentives.