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

January 31, 2017

Dear Leonardo,

Thank you for the opportunity to respond to Ofgem's consultation on the Initial Proposals for electricity SO incentives from April 2017. This response is made on behalf of Uniper UK Ltd.

Uniper is an experienced international energy company focused on power generation, energy trading, transportation, and storage, as well as a provider of specialist power engineering services. In the UK we own seven power stations comprising over 6GW of flexible installed capacity, as well as a fast churn gas storage site. As such Uniper is the fifth largest generator in GB and is making a major contribution to ensuring security of supply and providing a bridge to the energy market of the future.

The main points we wish to make are:

- We support the development of an electricity System Operator Incentive Scheme to cover April 2017-March 2018, based on but seeking improvements to the 2015-17 framework, while a more fundamental review of SO incentives is undertaken for future years.
- The major developments over the last few years, including the growth of intermittent and embedded generation, interconnection, and the evolving SO's role, mean that such a review is vital to ensure the design of future incentive schemes remains appropriate going forwards.
- Wherever possible balancing services should be procured through competitive processes.
- Greater consistency in the reporting of the System Operator's actions both in the procurement of balancing services and their subsequent use and dispatch are crucial. Some services from certain classes of providers are currently not reported to the same extent as others and this is distorting competition between parties.

Our specific answers to the consultation questions are set out below.

**CHAPTER: Two**

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

Yes, we welcome the introduction of a new C16 licence condition on balancing principles, including the requirement for National Grid to evaluate the relative cost of contracting outside the Balancing Mechanism versus resolving a situation through the Balancing Mechanism. Requiring greater transparency to address the current asymmetry of information between Ofgem, National Grid, BM and non-BM parties is also an important step forward. We agree that as fundamental principles to ensure a level playing field between competitors, it is appropriate for these to be included in licence conditions rather than informal guidance.

**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?**

We agree that NGET's licence should be amended to include new Balancing principles conditions. Providing a guidance document to set out further the level of detail expected in requirements such as the reporting of model errors would also be helpful to aid both NGET's and stakeholders' understanding of the benchmarks that NGET's performance will be assessed against.

We are unsure why the final proposed bullet point regarding procurement of balancing services using a competitive approach currently states "'wherever this is in consumers' best interests". Running a transparent, competitive procurement process should always be in the consumers' best interests. As Ofgem have noted in 6.10, while bilateral contracting might sometimes seem a cheaper short-term approach, longer-term this risks increasing costs due to an adverse impact on the competitive market.

The proposed introduction of further licence changes to put obligations on NGET to improve transparency and openness of procurement from April 2017 is also a step forward. Presently, the level of reporting across services and classes of service provider is inconsistent. This is distorting competition and preventing participants from fully understanding market fundamentals which can affect prices both for these services and in the wider energy market. While the principles set out in 6.13 are welcome, further detail is desirable to fully understand what Ofgem intend.

For instance the proposal that NGET must be economic and efficient by "publishing the system operation information electricity market participants need….producing and publishing reliable and unbiased forecasts of future margins, demand, wind generation and balancing costs". It is not clear exactly what this is suggesting beyond the assessments of those components included in the incentive scheme: what type of demand, what timescales or granularity, how else accuracy would be measured, or what the implications of NGET not achieving those standards might be. We trust that this detail is still being considered and in due course may be clarified and consulted upon in a guidance document like that Ofgem propose to produce for the Balancing principles licence conditions.

We would also suggest that the principle on transparency could be widened slightly to say (our emphasis) "ensuring the procurement ***and utilisation*** of balancing and ancillary services is as transparent as possible".

**Question 3: Do you agree with our Initial Proposal of maintaining a model-based target from April 2017 until March 2018?**

Yes, continuing with BSIS models targets for 2017-18 with material changes is a practical approach while the in-depth review of the regulatory framework is undertaken in tandem. However, it is important that the fundamental review is not delayed; it would not be desirable for the proposed approach to be extended beyond 12 months. We look forward to Ofgem's spring publication of initial thoughts from the longer-term review.

**Question 4: Do you agree with our proposed changes to the governance and incentive parameters? Is there anything missing or that should be removed?**

We support Ofgem's proposed changes to governance arrangements to require independent checks of NGET's methodologies and assumptions in order to assess whether models are fit for purpose before they are submitted for Authority approval. Additional requirements that NGET provide monthly data submissions to the Authority and a final independently audited submission are an improvement, as is expanding the ongoing error identification and correction process. However, we hope that NGET will notify Ofgem of any model errors identified at the earliest opportunity, instead of waiting up to two weeks as the new framework will allow. It would also be useful to have further information on the implications of the incentive scheme being put on hold when NGET informs Ofgem of, or the Authority directs investigation of an error.

Regarding the incentive parameters, there is some merit in lowering the scheme cap to £10m, although we believe that the floor could have been maintained at the existing level. We support the introduction of the backstop parameter to mitigate windfall gains or losses from model errors.

**CHAPTER: Three**

**Question 1: Do you agree with our proposal to remove Black Start from BSIS?**

Yes, given the changes in the generation mix and events during the last incentive scheme, resulting in significant increases in costs to customers, removing Black Start from BSIS and setting a bespoke scheme for these costs with an ex-post evaluation is more appropriate.

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

We agree with the principles outlined for clear and robust decision-making, diversification and efficiency, and are pleased that Ofgem has highlighted the importance of transparency regarding the approach, procurement and use of Black Start services. However, flexibility of approach for the licensee to consider a variety of procurement and strategy options should not be allowed to have a negative impact on transparency or the promotion of competition. It is important that transparency to the market is maintained for procurement of Black Start as well as other balancing services.

**Question 3: Do you agree with our proposed regulatory framework for 2017/18?**

Yes, Uniper supports Ofgem's proposed framework for the 2017-18 scheme. We agree with the introduction of a requirement for NGET to set out a strategy and procurement methodology for Black Start that seek to minimise costs to customers and that actions can subsequently be measured against; also, that this approach should still be reviewed after twelve months. It would also be an improvement to introduce an assessment including third-party oversight of Black Start activities in an audited report, with the potential for any non-compliant costs to be disallowed. We hope this combination of incentives will lead to more efficient procurement for 2017-18 while further work is undertaken to explore alternative options for future licence obligations or incentives on desirable SO behaviours.

**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?**

Yes, we agree with Ofgem's proposals. Accurate wind forecasts in themselves are beneficial to the SO and in theory should not require incentivising. However, persistent overforecasting of wind generation by NGET and worsening performance over summer 2015 and summer 2016 suggests that maintaining a day-ahead incentive is justified. Introducing measurement against half-hourly forecasts may also help to drive improvements. With BOAs continuing to be excluded but both transparency and accuracy of forecasts important to the market, requiring NGET to explain the impact of BOAs on wind forecast accuracy would also be useful, though we would prefer to see this information closer to real time than on a quarterly report.

**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?**

We note the proposed introduction of forecasting incentives at day-ahead, two days-ahead and week-ahead for NGET's national demand forecasts (i.e. underlying demand minus distributed generation and demand side response). We are more interested in the day-ahead and hour-ahead, not pre day-ahead outlook, and in settlement period data not forecasts for cardinal points; nevertheless, incentivising improvements in demand forecasts for these points in time is a step in the right direction. It would also be helpful to parties to see the underlying gross demand forecasts, and the embedded generation split by wind, PV, and other embedded, at half-hourly granularity. We welcome Ofgem's intention to keep this under review and consider a half-hourly granularity for the enduring incentive scheme from 2018.

**Question 3: Do you have any additional criteria that you would propose for the Quarterly Forecast Report?**

It will be useful for parties to see the proposed breakdown of actual and forecast demand components per settlement period, from year-ahead to day-ahead, and wind output unwound from week-ahead to 4 hours ahead, combined with NGET's explanation of the impact of BOAs on wind generation forecast accuracy. At present we do not propose any additional criteria for this quarterly report. As previously stated though, it would be preferable if such elements were also published at settlement period granularity closer to real time. It is not clear to us to what extent these wishes might be addressed if NGET begins to release further forecast data in a step towards meeting a new licence condition for improvements in transparency.

**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 satisfied with Ofgem's suggested approaches.

**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?**

Yes, this seems appropriate and we consider that the seasonal breakdown and linear forecast incentives suggested are reasonable for the 2017-18 scheme. With NGET's recent overforecasting being in the region of 72% of the time, compared with 63% of the time between 2013 and 2015, a 60% target seems realistic.

**CHAPTER: Five**

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

Yes, we support introducing the pilot scheme as set out to establish a mechanisms framework, for 2017-18 restricted to Scottish TOs' networks, reported quarterly and requiring applications to the Authority for projects exceeding the £1.4million pot.
However, we remain concerned that passing costs from the TO business, which are normally recovered over a longer timeframe, to the SO business, with cost recovery typically over a year or less, could still risk even greater volatility in balancing costs year on year.

We also continue to believe that there are arguments for making this a two-way mechanism; the SO may incur costs owing to TO actions and arrangements should also be put in place for monies to flow from the TO to SO in such circumstances. It would be helpful if Ofgem could consider this possibility alongside the potential for SO-DNO transactions that is also being evaluated for April 2018 onwards.

**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?**

Yes, we agree with the proposed pilot of an SO-TO incentive. The structure seems reasonable, although the proposed +/-£1m cap and floor is perhaps rather large compared with the size of the fund pot. This approach would be consistent with the other incentives suggested for the 2017-18 scheme.

**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?**

Yes, a quarterly report on all projects considered will improve transparency and also help Ofgem to assess the benefit of maintaining or extending this mechanism beyond March 2018. We are pleased to see that Ofgem also propose to require NGET to consult industry on the outcomes of this mechanism at year end and ensure third party validation of their final report to the Authority one month after the scheme ends.

**CHAPTER: Six**

**Question 1: Do you agree that the proposed changes describe in Chapter 2 will enhance transparency?**

Yes, subject to our comments to earlier questions, we agree that these improvements should help to provide much-needed improvements to transparency in the market with regard to the procurement of balancing services and actions undertaken by the SO.

**Question 2: Do you agree with our proposal to not introduce a financial incentive on transparency?**

Yes, transparency is vital for fair and efficient operation of the market and should be a fundamental principle not requiring an incentive or warranting a reward. Consequently we strongly support Ofgem's proposed clarifications to NGET's licence to include requirements for transparency (with a guidance document to provide further clarity on the minimum details required if there is any ambiguity in the licence wording). We do believe, however, that this issue is of sufficient importance that Ofgem should monitor National Grid's compliance with this principle closely to ensure that the market receives the information it needs to operate efficiently to the ultimate benefit of customers.

**Question 3: Do you agree with our proposal to retain the MDLC?**

While Ofgem previously proposed not to maintain the MDLC, we agree that there is merit in maintaining some form of incentive to ensure that simple and cost effective model improvements are still pursued.

**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?**

Yes, we agree with Ofgem's proposal to amend the licence condition to include a requirement for NGET to ensure third party scrutiny of aspects where the models could be improved.

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

Yes, this seems to have been redundant since 2015; there is no longer a need for this mechanism.

We hope that you find our response to be of help and we would be happy to discuss any aspect with you further.

Yours sincerely,

Esther Sutton
Uniper UK Limited