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David Beaumont – SO Regulation, Energy Systems, Ofgem

19th January 2018

BY EMAIL ONLY TO: electricitySOreform@ofgem.gov.uk

Dear Sirs

Consultation on The Electricity System Operator Regulatory and Incentives Framework from April 2018

As part of the Transmission Capital Partners consortium, Transmission Investment manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of Offshore Transmission Owner (OFTO) assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs and Westermost Rough offshore wind farms - a portfolio of over 1000MW (circa £800m in capital employed).

Transmission Investment is leading, in partnership with the French national grid company RTE, the development of a proposed 1400MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project"). This project was granted cap & floor regulatory treatment in 2015 and is expected to commence construction shortly.

Transmission Investment remains a strong advocate of introducing competition into the delivery of onshore transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations and, when called upon, providing evidence to parliament. Independence of the SO is a necessary condition for this competition to be successful.

As requested we are providing a view on aspects of the new framework as well as responses to the ten specific questions raised in the consultation document.

We very much welcome the consultation on Ofgem's 'minded to' position and, as we have stated previously, we are very supportive of the move towards removing the conflicts of interest, perceived or otherwise from the National Grid Group. We see the move towards a more independent ESO through legal separation as the first step towards achieving these goals. Further and as stated in previous consultation responses, we are strong advocates of full ownership separation and see it as the ideal solution to fully alleviating these issues. Full ownership separation will ensure fair competition, increase the relative effect of financial incentivisation and therefore better ensure a secure, flexible and efficient system.

In terms of the new approach to incentives we support the view that whilst previous mechanistic incentives worked well in the relatively stable environment of the past few years, the rapid change that the industry now faces requires something different. The proposed evaluative approach should create the flexibility to ensure efficiencies are encouraged in the near term whilst not losing sight of the longer term industry requirements. However, achieving the balance between the two may not be straight forward. Splitting the incentive pot equally across the seven proposed principles requires the principles to be of equal benefit. This may be difficult to achieve, especially over the longer term. Applying an annual weighting to each of the principles based on recommendation from the Performance Panel will allow further flexibility as well as year on year adjustment to the priorities. This should allow the financial incentives to adapt with the requirements of the market whilst not having to change the fundamental principles.

However, a concern is that the required change the ESO must facilitate and oversee will be challenging and, as stated in the consultation document, possibly requiring a degree of risk taking. In the longer term and if ownership separation was implemented, the resulting business should be of a size to be incentivised into taking the required risks by a financial performance window. However, with the ESO as an independent element within the NG Group, the relative value of these incentives against the Group returns may be overshadowed by any political impacts the ESO may have on the NG Group as a whole. In that context the rapid and required changes may not be optimally achieved as the financial incentive to take the required risk of change maybe overshadowed by the potential reputational impact to the much larger NG Group. We feel that financially incentivising the ESO as an independent entity within the NG Group has less chance of fulfilling longer term objectives due to the increased risk-adverse nature the ESO would be required to take as part of the NG Group.

We very much welcome the inclusion of direct incentivisation on increasing competition in networks especially given its omission from National Grid's publication: "The future of the electricity System Operator". However, it must be challenged whether the financial incentive associated with Principle 7 – *Facilitate timely, efficient and competitive networks,* is sufficient for the ESO, as part of the NG Group, to override any potential internal conflict of interest. This conflict, perceived or otherwise, is exacerbated when considering the context of the financial detriment to the NG group the increase in competition will cause if optimally implemented.

In order to alleviate this, an added incentive to facilitate the ESO's move out of the NG Group may be warranted. If through the proposed framework an internally looking incentive for the ESO to separate as much as possible from the NG Group would add benefits in two ways: it would help ensure the independence of the ESO in the NG Group in the short term and also ease the ownership separation in the longer term.

In terms of the ESO roles an omission we have identified is ensuring that facilitation of competition in markets is not restricted to internal GB markets. With the possible exclusion of the UK from the IEM there is no single entity responsible for ensuring that GB markets are complimented by the benefits of cross border access. Currently facilitation of cross border trading is ensured through our inclusion and compliance with the legislation that the IEM requires. If this requirement is weakened, we feel it is important that the ESO role of 'facilitating competition in markets' includes ensuring that UK markets are compatible and promote the increased competition which cross border trade enables.

Our response to the detailed questions can be found in Annex 1.

We should like to reiterate that we are supportive of the vast majority of the proposals made in the consultation and consider that when implemented they will deliver a significant step forward to creating the industry structure that is needed in the future.

If you would like to discuss any of the comments above please feel free to contact me.

Yours faithfully

By email

Richard Sidley
Regulatory and Commercial Manager

Annex 1 – Detailed questions

Q1 – Do you agree with our updated roles and principles for the ESO

Largely yes. We feel the ESO should be identified as the entity to ensure the GB markets are compatible with neighbouring markets and the benefits of cross border trade and sharing of reserves can be realised and facilitated by the ESO.

Q2: Do you agree with our proposals for the ESO Forward Plan? Do you think our proposed process for reviewing the ESO's Forward plan will create a sufficient incentive on the ESO to develop a plan and performance metrics that are appropriately challenging and comprehensive?

Largely yes – In terms of the roles 'managing system balance and operability' and 'facilitating competition in markets', it is clear how the forward plan could set out annual efficiency targets. However, it is not clear to us how the longer-term vision is realised through the annual performance targets. If the required industry change is the longer-term goal then realising the vision is the important element of each performance year. The consultation is not clear on how far the annual targets will be mapped out or how the ESO will be judged in future years if the longer-term targets slip. If performance is managed on a year by year basis how is any delay to the vision (or the step by step view of achieving the vision) penalised? We would promote more of an approved road-map style to the longer-term objects, within annual milestones clearly stated using a 'SMART' form of approach.

Q3: Do you agree with our proposals for within-year reporting? Do they appropriately balance the need for transparency with resource burden for the ESO?

We do not feel within year reporting is required – if the longer-term change is the required outcome, a mid-term review will not add much value. Any progress against agreed deliverables could be published on an ad-hoc ongoing basis with an end of year report.

Q4: Do you agree with the design of our evaluative scorecard incentive? Do you have views on the Panel scoring criteria or payment-penalty methodology?

[No response]

Q5: Do you agree with our proposed scheme cap and floor of ±£30m?

No further comment other than described in the general comments of the covering letter.

Q6: Do you agree with our proposal to introduce a new ESO Performance Panel?

Due to the subjective nature of the new incentive scheme, we see this as a good methodology to evaluate the ESO targets and performance.

Q7: Who should sit on the ESO Performance Panel? What is its appropriate size?

We agree the consultation that Option 3 is the most appropriate membership mix for the Performance Panel. We would add that a significant proportion of the Panel should consist of members who have never worked within the NG Group. This we feel will help with innovation whilst not creating unrealistic outputs. Any affiliation with the NG Group (including Pension) should be declared.

The consultation states that the panel should have an odd number of members – we do not feel this is required as the resulting recommendation to GEMA may hide the views of a significant but minority number of members. A more appropriate output as part of the recommendation may be to show the number of members supportive (or not) of the recommendation. If there is a split vote the recommendation could show the opposing opinions with GEMA taking the final decision.

We do not have a view on the size of the panel membership but do agree with representation from mixture of industry parties.

Q8: Who should chair the ESO Performance Panel?

We agree with the consultation that the Chair person should ultimately be independent. However, care should be taken to ensure that the person is entirely independent from the NG Group including any on-going Pension arrangements.

Q9: Do you agree with our proposed approach to implementing our new framework

[No response]

Q10: Do you have any comments on the draft license changes

[No response]