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Dear David,

The Electricity System Operator Regulatory and Incentives Framework from April 2018

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.

We welcome the proposals and support greater stakeholder involvement in developing strategic and operation plans for the Electricity System Operator (ESO) and assessing its performance. The proposals can be strengthened further in a number of ways, including:

- The ESO should be required to review and revise the Forward Plan to address any concerns highlighted in the Formal Opinion.
- While the new arrangements are being implemented, Ofgem should scrutinise and challenge the 2018/19 Forward Plan in lieu of the Performance Panel.
- Ofgem should formally consult stakeholders on the proposed level of reward or penalty for the evaluative incentive before a final decision is made.
- To limit the risk of windfall gains, the maximum reward/penalty should be maintained at $\pm£15m$ until all reforms proposed in the consultation are implemented.

We hope you find these comments helpful. Answers to the consultation questions are attached. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
Director - Network Regulation, Forecasting and Settlements

Answers to the consultation questions

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?

The proposals for the Forward Plan are an improvement on current arrangements. We suggest the proposals are further improved by placing an obligation on the ESO to review and revise the Plan to address concerns in the Formal Opinion where relevant. It is possible that, without such an obligation, the ESO may undertake a programme of activities within a regulatory year that may not maximise consumer benefits.

The Formal Opinion will form part of the evidence base the Performance Panel should consider when conducting its annual assessment and scores could be moderated because of concerns identified in the Formal Opinion. However, the reduction in the reward or the increase in the penalty to the ESO may not be greater than the consumer benefits not delivered. Therefore, an obligation on the ESO to take account of the Formal Opinion should act as a 'backstop' to protect consumers.

We also suggest the Formal Opinion is provided ahead of the regulatory year in time to allow the ESO to revise the Forward Plan if necessary.

To ensure that stakeholders and the Performance Panel are able to assess whether a Forward Plan is appropriately challenging it will be important that the ESO includes evidence, such as comparable historic data and trends, to support any proposed performance metrics and benchmarks.

The 2018/19 Forward Plan will not be scrutinised by the Performance Panel ahead of that regulatory year because it will not yet have been convened. Ofgem should provide that scrutiny to ensure the ESO adopts a Plan that reflects consumers' long-term interests.

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?

The Performance Panel should publish all performance assessment reports and the evidence submitted for those assessments.

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?

Ofgem should formally consult stakeholders on the proposed reward/penalty before the final decision is made. This further enhances the role of stakeholders in the process.

In chapter 3 of the consultation, the description of the annual evaluation process suggests the Performance Panel may not be able to exercise discretion when recommending scores. If assessing a particular aspect of performance does not require judgement, then it is more appropriate for that to sit with Ofgem.

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

We note the transition to the new framework during 2018/19 - not all the proposed reforms (such as the Performance Panel's scrutiny of the ESO's Forward Plan before the relevant year) will be implemented for the 2018/19 regulatory year. The maximum rewards/penalties available via the 2017/18 interim scheme were limited to $\pm£15m$ while the new regulatory framework was being designed, to mitigate and limit the risks of windfall gains to NGET to the detriment of consumers. Whilst the reforms are being implemented, and then fully understood, we are not convinced that the risks of windfall gains (or losses) has reduced and so the maximum reward/penalty should be maintained at $\pm£15m$ for the time being. This should be done in a way that ensures incentives remain in place i.e. the cap/floor should not be reached more easily but other adjustments made.

For scheme years beyond 2018/19, we recommend the maximum reward/penalty is reviewed. Due to the nature of the ESO, with a relatively low regulatory asset value and therefore returns, the appropriate level of revenue that should be put at risk is not straightforward. This is particularly true with an independent system operator.

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

We support the introduction of the ESO Performance Panel. Wider involvement in challenging Forward Plans and assessing performance should lead to better outcomes for consumers.

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

We believe there should be a representative of licenced suppliers on the Panel. Suppliers will have a detailed knowledge of system charges, as they are required to pay them and forecast future levels, but will not typically have any commercial interests reliant to how the ESO spends money.

Q10: Do you have any comments on our draft licence changes?

Condition 4M.13 should be expanded to require the Authority to formally consult the industry before issuing or issuing any material revision of the ESORI Guidance Document.