

19 January 2018

David Beaumont  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Dear David,

**The Electricity System Operator regulatory and Incentives Framework from April 2018**

Drax Group is a UK-based energy company with businesses spanning generation and retail. In recent years we have transformed Drax Power Station into the UK's single largest source of renewable power by upgrading its generation units to use compressed wood pellets in place of coal. Alongside our biomass and coal units, our acquisition of open cycle gas turbine (OCGT) development sites is intended to allow us to play an important role in supporting a flexible power system that can reliably support wind and solar power generation.

Our retail businesses, Haven Power and Opus Energy, are actively engaged in helping businesses with their energy needs, improving efficiency and switching to renewable products. Haven Power is the UK's 5th largest non-domestic electricity supplier by volume. Opus Energy is the UK's 6th largest non-domestic gas and electricity supplier by meter count with over 300,000 supply points.

We welcome this opportunity to provide additional comments on the Electricity System Operator (ESO) regulatory and incentives framework that is to be in place from April 2018. Furthermore, we support the outcome of the review, particularly the expectation that competition should be at the heart of the ESO's objectives, ensuring a level playing field for all market participants, obligating open tender processes and delivering transparency of decision making.

We generally agree with the changes proposed by Ofgem and welcome continued emphasis on system management decisions being made on a "whole system" basis. To fully realise the benefits of this approach, there must be greater clarity and thought given to unbundling and the future role of Distribution Network Owners/Distribution System Operators. Our preference is for a common framework with clear objectives and a delineation of owner/operator responsibilities enshrined in licences.

One area of general concern is that the ESO may limit innovation and incentive proposals in its plans until the start of RIIO-2 in 2021. This delay is likely to have a negative impact on competition and innovation in regards to the contracting of system support services in the meantime, to the detriment of the long-term security and affordability of energy supplies.

Our response to the specific consultation questions can be found in Appendix 1.

Please feel free to contact me, should you wish to discuss any aspect of our response.

Yours sincerely,

*Submitted via email*

Paul Youngman  
Regulation Manager

## **Appendix 1: Drax response to the consultation questions**

### **Question 1: Do you agree with our updated roles and principles for the ESO?**

We broadly agree with the updated roles and principles identified by Ofgem. In particular, we are supportive of the proactive nature of the principles and expectation this places on the System Operator to facilitate actions that deliver the desired outcomes.

We welcome that the role of “Acting as a residual balancer” has altered to “Managing system balance and operability”. This change in part reflects, but does not fully mitigate, our concerns that it is difficult to envisage how a whole system approach can be adopted to addresses operability and security of supply whilst the future role of Distribution Networks Owners/Distribution System Operators remains unclear.

As a minimum there needs to be a common framework with clear objectives and a delineation of Owner/Operator responsibilities enshrined in licences. We have consistently made the case for a single independent System Operator (SO) across transmission and distribution networks. It is our view that a single independent SO is the most effective long term solution to achieving a fair, innovative and competitive market that secures future operability and security of supply.

### **Question 2: 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?**

We welcome the ESO Forward Plan and the framework proposed by Ofgem for its development. We are cautiously optimistic that the ESO will develop a plan and performance metrics that are appropriately challenging and comprehensive, although this will clearly require oversight from Ofgem and input from market participants. We agree that there is a valuable role for the ESO Performance Panel in robustly challenging and feeding back on the plan, both pre- and post-determination.

Where we have initial reservations is if the plan concentrates wholly on the immediate or short term system operation and market challenges. The energy system is transforming rapidly, challenging current views on future operability of the system and security of supply requirements. We believe that these challenges, which are beyond the short term horizon, should be addressed and frequently reviewed by the ESO. As such the ESO must be appropriately incentivised to develop markets that satisfy a range of future system support needs/scenarios.

### **Question 3: Do you agree with our proposals for within-year reporting? Do they appropriately balance the need for transparency with resource burden for the ESO?**

Yes. We agree with the reporting proposals and the obligations to engage with stakeholders and provide an appropriate narrative with respect to its performance. We would expect this to include the development of a range of KPI’s with measurable outcomes.

**Question 4: Do you agree with the design of our evaluative scorecard incentive? Do you have views on the Panel scoring criteria or payment-penalty methodology?**

We agree with the general position that a principles based, evaluative, incentive approach may steer the desired changes in the ESO. At its heart the incentive framework should prioritise the obligation to facilitate competition and ensure a fair and level playing field. These strategic objectives should be reflected within the scorecard, setting goals for the ESO to achieve by the end of year one, three and five. We are also mindful that the ESO is a regulated monopoly and that it will still be completely appropriate to have some mechanistic outputs and prescriptive requirements to mandate competitive procurement processes.

It also seems appropriate that the Performance Panel will be able to look back at previous reports and plans to consider longer term incentives and plans are continuing to be driven forward by the ESO. This will help set the context for assessing delivery, and also provide a useful check that initiatives become embedded into the ESO's normal operations.

We are less convinced by the criteria proposed in figure 6 of the consultation "*Conditions for each score category*". A number of the criteria seem iterative in nature, and it is not clear if the criteria is to be applied to the plan, outcome of the performance metrics, or both. Applying the criteria as designed could lead to non-reflective scores. For instance, if "*ambition within the plan*" had been classed *excellent*, but delivery *poor* or *average*, this could lead to a *good* score overall. Our assumption is that the criteria is for illustrative purposes and would be altered by the performance panel once it has convened.

With this in mind it may be difficult to determine, until after the first year of implementation, whether the proposed metrics are appropriately challenging. We would therefore expect that incentive payments would be awarded for truly exceptional performance i.e. business as usual or 'on target' performance would not be rewarded.

**Question 5: Do you agree with our proposed scheme cap and floor of  $\pm$ £30m?**

We agree with the proposed scheme for 2018-2019, with the provision that Ofgem will review and consult upon the values in future years 2019-2020 and 2021-2022.

**Question 6: Do you agree with our proposal to introduce a new ESO Performance Panel?**

In principle we agree with the introduction of the ESO Performance Panel and with Ofgem's statement that it should not be used by the ESO as a substitute for wider stakeholder engagement and transparency.

**Question 7: Who should sit on the ESO Performance Panel? What is its appropriate size?**

We agree with Ofgem that the panel should not be constituted exclusively by market participants, though the views of transmission customers and generators should have appropriate weight and representation. We think it is important that real or perceived conflicts of interest are minimised. This should be addressed through a balanced mix of independent and industry representatives, and appropriate terms of reference for the panel.

**Question 8: Who should chair the ESO Performance Panel?**

As outlined in the consultation, Ofgem should chair for the first year.

**Question 9: Do you agree with our proposed approach to implementing our new framework?**

Yes.

**Question 10: Do you have any comments on our draft licence changes?**

We are cautious that Ofgem appear to removing obligations placed on National Grid SO to develop models and forecast Balancing Services 4E and 4F, Wind Generation forecasting 4H and reporting obligations with respect to Transmission Losses. Though these obligations may be replicated in the ESO plan, it does not appear advisable to remove them from licence until the new framework is embedded.