

Mr David Beaumont
SO Regulation, Energy Systems
Office of Gas and Electricity Markets
9 Millbank
London
electricitySOreform@ofgem.gov.uk

19 January 2018

Dear Mr Beaumont,

RE: UK Power Reserve response to The Electricity System Operator Regulatory and Incentives Framework from April 2018

UK Power Reserve (UKPR) welcomes the opportunity to provide Ofgem with feedback on the proposed changes to the ESO Regulatory and Incentives Framework from April 2018.

Context of response

UK Power Reserve is the leading provider of secure, flexible, low carbon electricity and services to the UK power market. With an 823MW portfolio of decentralised thermal power generation and battery storage assets, we help keep the country's electricity system balanced and resilient. Our fast-ramping, low-cost assets are located across England and Wales, improving competition, contributing to security of supply, and delivering better value to consumers.

Response

UKPR welcomes the consultation and supports Ofgem's view that a persistent lack of transparency over the ESO's framework of activities and its performance needs to be tackled. In the context of the separation between the TO and the SO, we call for greater ESO accountability and we therefore support the main principles for a revised incentives scheme.

Ofgem's proposals, as outlined in the consultation paper, show a clear and ambitious set of changes that will allow the Regulator and the industry to assess in a transparent and holistic way whether to reward or penalise the ESO based on its performance.

We stress the need to move away from a framework that has been suffering from a lack of transparency and accountability, and which has hampered industry players from challenging the ESO's performance.

Updated roles and principles for the ESO

UKPR agrees with the structure of the set of roles and principles identified by Ofgem. We agree that greater separation between National Grid's SO functions and the rest of the group is necessary. The SO must be, and

be seen to be, entirely independent from conflicts with the rest of the NG business. It is essential that the industry receives full assurance of separation. This includes assurance that the remuneration of ESO staff will no longer be linked to the performance of other parts of the National Grid family of companies (through NG plc). Remuneration of ESO staff should be based solely on ESO performance.

For a real and concrete separation between TO and SO, it is most important to define the roles of the ESO as separate and independent entity. The new roles and principles identified by Ofgem contribute to define how the SO's connection to NG Plc will not cause a conflict of interest.

However, the ESO's role as system balancer is more complex than the first iteration of the roles and principles suggested. With regards to the first two roles (whereby the SO manages system balance and operability and facilitates competition in markets), UKPR would like to stress the importance that the SO develops procurement frameworks that recognise the paramount importance of investor confidence. Changes should be made with sufficient notice to industry and should reflect the essential investors' need to recover value from investments over time.

Whilst it will be important for SO procurement frameworks to keep pace with industry and technological change, committed investment, based on reasonable investor expectations must have a level of protection from rapid change. If this is not the case, future investment will be curtailed, giving rise to security of supply risks and greater costs to the consumer.

Furthermore, the SO should be incentivised to provide greater transparency around procurement of all ancillary and balancing services. This should be part of ensuring that a level-playing-field is created for distributed generation to compete with transmission generation in the balancing market. For example, decentralised generators will need assurances that their technologies, which will directly challenge the use of the NG owned transmission system, are treated fairly and objectively in the market place. Regular auditing of SO procurement and charging processes relating to ancillary and balancing services should be conducted and published.

Finally, to facilitate competition in markets, the ESO must work closely with industry. This should start by allowing industry governance in the Connection and Use of System Code (CUSC) to reflect the value of decentralised energy. The SO should therefore clearly demonstrate that it fully understands the value of distributed generators to consumers, to the GB electricity system and to the SO in balancing that system.

ESO Forward Plan and reporting

UKPR supports the principles of the mechanism envisaged by Ofgem, whereby the ESO has the obligation to produce a yearly Forward Plan. We welcome solutions that would make the SO accountable for its performance and that would guarantee transparency in the evaluation process.

Yet, the ESO should be required to duly consider stakeholders' feedback when setting its vision, deliverables, and its proposal of performance metrics linked to each of the principles identified by Ofgem. To value the foreseen engagement with stakeholders – and to substantiate the possibility to hold the ESO to account – the

ESO should be required to demonstrate that it took into account and addressed all concerns with a view to delivering for consumers.

Stakeholders should be involved throughout the planning process – from drafting to execution – by providing feedback and shaping the ESO's activities.

Reporting is therefore central in this process. UKPR welcomes Ofgem's commitment to ensure that stakeholders have access to as much information about the ESO's performance as possible. We support substantial quarterly reports and a mid-year review where performance is measured against its metrics. These are both good occasions whereby the ESO engages with stakeholders, the Performance Panel, and Ofgem on its progress. Such periodic reporting is suitable to balance the need for transparency with resource burden for the ESO.

On the other hand, the proposed monthly updates of the performance metrics - agreed at the start of the year as a default - could provide the ESO with the possibility to unilaterally change, amend or remove ambitious metrics as it sees fit. This would undermine stakeholders' expectations. Therefore, UKPR would not support such an update and would prefer a system, which, at the end of the year, would assess the ESO and make it accountable.

Evaluative scorecard incentive

UKPR supports the shift from ex-ante, mechanistic incentives to evaluative incentives, which lead to a reward or penalty determined by an evaluation of evidence at the end of the year. We agree with Ofgem's concern that continuing to set mechanistic financial incentives on discrete areas of ESO activity would not support the transition to a more accountable ESO.

This approach as well as the constant monitoring from industry (via consultations and participation in the Panel) help the ESO to bring forward the areas with greatest consumer value, while retaining a financial drive to encourage it to innovate and go beyond baseline expectations. The ESO should in fact only be financially rewarded for performance that goes beyond 'business as usual' expectations.

We think that the proposed scoring criteria and payment-penalty methodology guarantees a rather robust process and clear up-front evaluation criteria. We support the requirements according to which the ESO has to submit a final evidence report on its performance during the year, including an overview of performance against the Forward Plan, and evidence of delivered consumer value to be assessed and challenged by both the Performance Panel and Ofgem.

We welcome the process that involves the Performance Panel to score the ESO's performance against each of the principles using predefined criteria. This will allow industry and the Regulator to rely on a clear and predetermined framework also in case of dispute over achievements.

In the consultation, Ofgem refers to the ESO's requirement to go beyond baseline expectations. Ofgem associates an above average score with the delivery of "better practices, business models and technologies that lead to material improvements in the ESO's performance". UKPR reiterates again the need for the ESO to

demonstrate that it fully understands the value of distributed generators to the GB electricity system and its balancing.

Proposed scheme cap and floor

UKPR supports the proposal to set a maximum cap/floor for the financial reward or penalty. We also welcome the idea to split the total financial incentive pot equally among each of the seven ESO principles.

Some concerns though emerge with regards to:

- The amount of the cap and floor, which is proposed at $\pm£30m$ for 2018/19. This amount would represent an increase from $\pm£15m$ for last year's scheme. Considering that Ofgem is proposing changes to the regulatory and incentives framework only for an interim period between 2018 and 2021, such a substantial increase of the incentives seems rather disproportionate, and would increase the risk of volatility and uncertainty as the amount is recovered through Balancing Services Use of System (BSUoS) charges in the same way as it is now. Furthermore, as this would be the first year of the proposed changes, a more conservative approach would ease the transition to the new system.
- Recovering the amount through BSUoS charges levied on market participants during that incentive year. By stepping away from the original ex-ante incentives, the ESO would forecast its performance and adjust BSUoS charges only following the final incentive payment/penalty decision by the Authority. Ofgem should therefore run an in-depth Impact Assessment on the impact on market participants of the greater uncertainty over the final BSUoS charges. Simple feedback from Ofgem to the ESO throughout the year, as suggested in the consultation, would not be sufficient to mitigate the uncertainty.

ESO Performance Panel

UKPR welcomes the introduction of a new ESO Performance Panel as long as it can truly challenge and influence the ESO's plans and performance metrics. Although it is clear that Ofgem's intention is not to assign any decision-making powers to the Panel, UKPR believes that it is important to clarify that the opinion and evaluation of the Panel should be duly taken into account by the Regulator.

Ofgem should therefore be required to demonstrate that it took into account and addressed the opinion of the Panel.

UKPR favours a Panel that is representative of the industry and that gives the opportunity to all different types of market participants to be represented. A well-designed and diverse panel is key to reduce the information asymmetry between the ESO and Ofgem, and will add greater transparency to the performance evaluation process.

We therefore support a Panel that includes a balanced and representative mix of industry representatives and independent experts covering all parts of the electricity supply chain. The chair should be an independent person, who has a working knowledge of the ESO's role but does not represent a particular ESO customer.

Ofgem could act as the secretariat to the Panel, providing guidance on the information needed for the assessment of the ESO's performance.

We very much look forward to Ofgem's communication on the policy and we remain at your disposal should you require any clarification.

For any questions or remarks, please do not hesitate to contact me at alessandra.dezottis@ukpowerreserve.com.

Kind regards,

Alessandra De Zottis
Regulatory Affairs Manager
UK Power Reserve Ltd