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Submitted electronically to
electricitySOreform@Ofgem.gov.uk

19th January 2018

Response to: The Electricity System Operator Regulatory and Incentives Framework from April 2018, Consultation on our minded to decision

Dear David

innogy SE is a newly established European Energy company. Formally part of RWE AG, innogy SE has three business segments: Grid & Infrastructure, Retail and Renewables. The UK is a core territory for both our Retail and Renewables segments.

Please find attached our response to the Electricity System Operator Regulatory and Incentives Framework Consultation. This reflects the views of innogy SE's UK arms: npower and innogy renewables UK Ltd

We note that Ofgem are indicating that they are not planning to provide a 'Formal Opinion' on the new plan until the end of April. We believe that the incentives scheme should be approved before the start of the scheme year and that the billing of the incentive payments to customers should occurs throughout the year to avoid price shocks to customers.

If the scheme cannot be signed off at the start of the scheme year, we would suggest the final payments to either be pro-rated to exclude the months of the scheme year where there was no agreement or set them at the maximum penalty as this would prevent the incentives being based on months which have already occurred.

Any incentive payments to the ESO should be for actions which are clearly above their business as usual role. Innogy do not feel that this has been explored in the consultation as many of the roles and principles discussed in the document are business as usual processes required under to ESO's licence conditions. It is unclear how any over performance of these targets are to be assessed. Also any improvements resulting from incentives in one scheme year should be incorporated into the business as usual baseline for the following scheme year.

Innogy also believe that the case has not been made for increasing the proposed incentive payments to +/-£30m or the decision to split the incentive pot equally over the seven principles. Although there is a change and increase in the number of areas on which the ESO is being incentivised most of these are already being done by the ESO and we cannot see how there is enough additional benefit to the consumer by doubling the potential incentive payment. Moreover, the new principles are not increasing the amount of work undertaken by the ESO, they merely represent a new means of measuring the ESO performance. Measuring performance in a different way does not increase the benefit delivered, it simply enables Ofgem to ensure they are covering a wider range of activities as part of their scrutiny. During a period where there is intense scrutiny of the profit margins of monopoly regulated businesses in the electricity industry we would suggest that Ofgem should consider this carefully.

There are areas of the new incentive scheme where TO decisions impact on ESO targets. The best example of this is constraints. The investment decisions of TOs are based on their own estimate of related constraint costs, and if there are unexpected financial repercussions as a result, these will all be placed on the ESO with no impact on TOs.

For the scheme year 18/19 we believe that industry should be given the opportunity to review the incentive targets before scheme go-live as the panel will not be formed until October. We also believe that assessment of performance by the panel, and relevant data, should be disseminated through the industry to allow challenge from all interested parties. There should also be additional work by the industry to close the gap on “asymmetric data” to allow accurate assessment.

I attach our response to the consultation to the response below. Please feel free to contact me.

Kind Regards

William Jago
Network Charging and Regulation Lead
Innogy SE
(by email so unsigned)

ANSWERS TO CONSULTATION QUESTIONS

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

Yes. These are in line with what an ESO should be doing in an open market to facilitate transparency and competition whilst trying to reduce costs. Many of these should be BAU operations not part of an incentive scheme.

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?

Proper scrutiny of the forward plan is required. Throughout the consultation there are numerous references to 'asymmetry of information' between the ESO and Ofgem. This fundamental difference makes it harder for Ofgem and the Panel to challenge the ESO on their forward plan. Innogy do not believe simply including an external panel, to provide their views on the plan, will improve the process since much of the data required is held internally by the ESO. Even industry experts may be unable to assess where the baseline is and what stretch targets for the maximum scores should be. It is also questionable whether the ESO should be setting their own targets.

Without seeing the initial metrics it is impossible to comment on whether a plan is appropriate.

The ESO's forward plan must be signed off and agreed before the start of the scheme year with defined principles for within year billing (this is currently not the case). Any delay to the scheme sign-off should result in pro-rating the incentive payments at the end of the year or charged at the full negative incentive. This will encourage early agreement of the incentive scheme as this would prevent the incentives being based on months which have already occurred.

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?

Innogy agree that there should be within-year reporting of the ESO's performance. This should then result in the adjustment as necessary to the within year billing of the incentive payments by customers to ensure there is no end of year bill shock, either through large over or underpayments. The current BSIS methodology allows for calculation of this daily throughout the scheme year but has not been referred to in the consultation document. This needs to be addressed. We understand how BSIS daily incentives are calculated based on quantitative data but the document is unclear how this would work for qualitative data.

Innogy feel that the decisions on this year has been left very late which reduces the scope to challenge any proposals.

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?

Scorecard Criteria:

The scorecard aligns with previous BSIS schemes, where there is an anticipated level of service, and measures of poor performance – with a proportional -ve incentive payment down to the collar- and outstanding performance - with a proportional +ve incentive payment up to the a cap. Whilst there is nothing new in this concept to warrant comment, the lack of an indication of the criteria or performance metrics to be included make it impossible to say whether the methodology will be successful in creating incentives.

We are unclear as to whether the cap and collar will apply to the total incentive amount, the individual principles or the individual criteria.

Payment-penalty methodology:

Innogy do not agree with the payment-penalty methodology. We are concerned that splitting the pot over the seven principles has no relation to their value to customers. In previous years the incentive payment has been based on actual cost reductions for the consumer (BSIS). Giving equal weight to each principle could lead to easier targets. We are still unsure how challenging the targets will be.

Innogy believe that the case has not been made for increasing the proposed incentive payments to +/- £30m or the decision to split the incentive pot equally over the seven principles. Although there is a change and increase in the number of areas on which the ESO is being incentivised most of these are already being done by the ESO and we cannot see how there is enough additional benefit to the consumer by doubling the potential incentive payment. Moreover, the new principles are not increasing the amount of work undertaken by the ESO, they merely represent a new means of measuring the ESO performance. Measuring performance in a different way does not increase the benefit delivered, it simply enables Ofgem to ensure they are covering a wider range of activities as part of their scrutiny. During a period where there is intense scrutiny of the profit margins of monopoly regulated businesses in the electricity industry we would suggest that Ofgem should consider this carefully.

An example of this would be 'Principle 3 - Ensure the rules and processes for procuring balancing services maximise competition where possible and are simple, fair and transparent'. Ofgem states in the appendices that to achieve this the ESO could publish requirements and its approach to balancing services on its website. This has already occurred so where would the additional work above their business as usual approach be? The suggestion that this could be potentially worth £4.3m in 2018/19 to the ESO for work which is currently undertaken does not seem justified in terms of cost to customers.

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

No. There is to be a doubling of the scheme cap in 2018/19. There is no quantitative analysis to show that the ESO will be doubling the benefit for consumers. Many of the areas identified within the scheme are business as usual processes.

Innogy believe that the case has not been made for increasing the proposed incentive payments to +/- £30m or the decision to split the incentive pot equally over the seven principles. Although there is a change and increase in the number of areas on which the ESO is being incentivised most of these are already being done by the ESO and we cannot see how there is enough additional benefit to the consumer by doubling the potential incentive payment. Moreover, the new principles are not increasing the amount of work undertaken by the ESO, they merely represent a new means of measuring the ESO performance. Measuring performance in a different way does not increase the benefit delivered, it simply enables Ofgem to ensure they are covering a wider range of activities as part of their scrutiny. During a period where there is intense scrutiny of the profit margins of monopoly regulated businesses in the electricity industry we would suggest that Ofgem should consider this carefully.

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

Innogy broadly agree with the introduction of a new ESO performance panel. There are concerns around the validity of this process if all data is provided by the ESO with no other independent source data.

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

Innogy broadly agree that option 3 is the best solution with a maximum panel size of around 10 people. We support the dissemination of information throughout the industry to allow challenge from all interested parties.

Q8: Who should chair the ESO Performance Panel?

Innogy think this should be a consumer group representative with sufficient industry knowledge.

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

We are concerned that there are very short timescales between the closing of the consultation and the start of the scheme in April. Therefore there seems to be little opportunity to challenge the plan for 18/19. This reinforces our point that proposals need to be clearly set out before the start of the scheme year.

If the scheme cannot be signed off at the start of the scheme year, we would suggest the final payments to either be pro-rated to exclude the months of the scheme year where there was no agreement or set them at the maximum penalty as this would prevent the incentives being based on months which have already occurred.

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

No.