

David Beaumont
SO Regulation, Energy Systems
Ofgem
9 Millbank
London
SW1P 3GE

19 January 2018

Dear David,

**THE ELECTRICITY SYSTEM OPERATOR REGULATORY AND INCENTIVES
FRAMEWORK FROM APRIL 2018**

Thank you for the opportunity to comment on the proposed changes to the Electricity System Operator (ESO) regulatory framework from 1 April 2018. This response is on behalf of ScottishPower. ScottishPower Energy Networks is responding separately on matters specific to our networks businesses. Our answers to your questions are in Annex 1 to this letter.

Given the rapidly changing energy system needs and the important role that the ESO has in maintaining security of supply, Ofgem needs to be clear about its expectations and ensure that the ESO is accountable to its wider stakeholders.

In setting the new ESO regulatory and incentives framework it is important to treat the period 2018-2021 as transitional. A key consideration for the ESO incentive scheme in future will be how it interacts with the RIIO-2 price controls for transmission and distribution network companies. It is vital that all these regulatory regimes interact effectively to ensure all parties work together to deliver more efficient whole system outcomes.

We broadly support the use of financial incentives for the ESO to create an environment that encourages and promotes greater transparency, innovation, improvement, fair treatment of all market participants and a focus on consumer benefits. However, it is important to strike the right balance between the use of financial incentives and the enforcement of licence obligations, and to clearly articulate the case for financial incentives to establish their legitimacy. Accordingly, we are pleased that the guidance on the SO's updated roles and principles sets out the expected behaviours and outputs from the SO in complying with its obligations under Standard Licence Condition C16.

We support the proposed requirement on the ESO to produce forward-looking plans with its stakeholders to demonstrate how it will maximise consumer benefits against each of the new proposed principles. These plans should contain details on how the ESO intends to focus its efforts on establishing a competitive and truly transparent market place - as this remains the best means to protect consumers' interests in both the short and long term. Transparent procurement of balancing services can be achieved through clear product specification, published selection criteria, reporting of outcomes/results of procurement activities and of the rationale for contracting decisions.

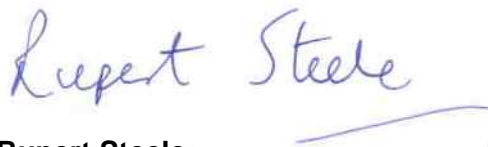
We consider that the SO should show a greater willingness to contract over the longer term for services where this is likely to lead to consumer benefits; accordingly, the plans should also include a long-term view (around 20 years) of future system needs. This view should include an assessment of whether existing markets and products are likely to bring forward technologies and solutions that are in the best interest of consumers.

The success of the proposed Performance Panel will depend on the panel having the appropriate knowledge (we broadly support the proposed membership of the panel) and striking the right balance between allowing for judgement and not creating too much uncertainty in setting the evaluation criteria. As the benefits from some actions taken by the ESO may not materialise for several years (eg longer-term solutions that reduce whole system costs), the Performance Panel will have an important role in ensuring that the ESO is held accountable on longer-term commitments and initiatives.

Lastly, given the fundamental changes being made, we support Ofgem's plans to review the effectiveness of the new approach over the course of 2018/19 and to consider if there is a need to make further refinements from 1 April 2019.

Should you have any questions regarding this response, please don't hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation

**THE ELECTRICITY SYSTEM OPERATOR REGULATORY AND INCENTIVES
FRAMEWORK FROM APRIL 2018– SCOTTISHPOWER RESPONSE**

Question 1

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

Yes, we are broadly supportive of the roles and principles for the ESO. However, we suggest Ofgem should consider further whether it would be appropriate to include a specific principle around the need to deliver system safety and security of supply.

While we agree it is important to include ‘supporting competition in networks’ as a principle, we wonder how practicable it will be to evaluate performance in this area, at least in the early years when it is likely that there will be limited opportunity for activity. Accordingly, rather than splitting pots equally across all the principles, it might be appropriate for this principle to carry less weight in the short term.

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?

Yes, we support the proposed requirement on the ESO to produce forward-looking plans with its stakeholders to demonstrate how it will maximise consumer benefits against each of the new principles. As part of these plans we would expect to see details of how the ESO intends to focus its efforts on the establishment of a competitive and truly transparent market place - as this remains the best means to protect consumers’ interests in both the short and long term.

Transparent procurement of balancing services can be achieved through clear product specification, published selection criteria, reporting of outcomes/results of procurement activities and of the rationale for contracting decisions. We consider that the SO should show a greater willingness to contract over the longer term for services that are likely to lead to consumer benefits. Accordingly, the plans should also include a long-term view (around 20 years) of future system needs. This view should include an assessment of whether existing markets and products are likely to bring forward technologies and solutions that are in the best interest of consumers.

If the review of the plan is appropriately resourced and robust, this should provide a sufficient incentive on the ESO to develop a plan and performance metrics that are appropriately challenging and comprehensive.

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?

The added value from the additional reporting requirements is something that should be reviewed over the course of 2018/19 to see if further refinements would better balance the need for transparency with resource burden for the ESO. In particular, it is not immediately clear to us that a monthly frequency is necessary.

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?

Continuing to set mechanistic financial incentives on discrete areas of the ESO's activity is unlikely to be the best approach to support overall future goals. However, as highlighted in the consultation, the success of an evaluative scorecard will be heavily reliant on a robust process and clear up-front evaluation criteria. It will be important to strike the right balance between allowing for judgement and not creating too much uncertainty in setting the evaluation criteria.

Question 5

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

Yes, we believe that the proposed cap and floor are appropriate.

We are broadly supportive of the use of financial incentives (including the proposed cap and floor) for the ESO to create an environment that encourages and promotes greater transparency, innovation, fair treatment of all market participants and a focus on consumer benefits. It is, however, important to strike the right balance between the use of financial incentives and the enforcement of licence obligations, and to clearly articulate the case for financial incentives to establish their legitimacy. Accordingly, we welcome that the guidance on the SO's updated roles and principles sets out the expected behaviours and outputs from the SO in complying with its obligations under Standard Licence Condition C16.

Question 6

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

Yes, we broadly agree. The success of the Performance Panel will depend on ensuring that the panel has the appropriate knowledge (we broadly support the proposed membership of the panel) and striking the right balance between allowing for judgement and not creating too much uncertainty in setting the evaluation criteria. As the benefits from some actions taken by the ESO may not materialise for several years (eg longer-term solutions that reduce whole system costs), the Performance Panel has important role in ensuring that the ESO is held accountable on longer-term commitments and initiatives.

Question 7

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

We broadly support the proposed make-up of the panel and believe it is important that there is strong representation from transmission networks companies. We do, however, believe that there are merits in considering additional independent members (perhaps retired/semi-retired industry experts). The panel should have between 9-11 members. This should ensure that all appropriate market participants views are represented, there is an appropriate level of knowledge, the length of meetings and costs are manageable and that decisions can be made within reasonable timeframes. Where appropriate, the panel members should be elected through an industry process.

Question 8

Who should chair the ESO Performance Panel?

Given the proposed interaction with the Authority, we believe that the working group should be chaired by Ofgem (a senior representative with working knowledge of the ESO and its role). This approach should ensure that the Authority has the required information to make good, informed and timely decisions.

Question 9

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

While these changes have been expected for some time, the implementation timescales appear to be relatively tight and ideally the Performance Panel would be in place to review the ESO's first plan. Given that these changes are a fundamentally new way of regulating the ESO, we welcome plans to review the effectiveness of the new framework over the course of 2018/19 and make any necessary changes from 1 April 2019.

Question 10

Do you have any comments on our draft licence changes?

No, they appear to achieve the stated objectives.

ScottishPower
January 2018