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By email only to: ESOperformance@ofgem.gov.uk

30 November 2018

Dear Grendon

Call for input on 2019-20 ESO regulatory and incentives framework

Thank you for the opportunity to respond to the above call for input. This response should be regarded as consolidated on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc.

We agree with Ofgem's approach that aims to avoid making fundamental changes to the ESO's framework at this stage due to the infancy of the framework. As well as this providing Ofgem with time to test different approaches e.g. on performance evaluation as the ESO becomes a legally separate entity, it will also enable Ofgem to consider how the ESO's role will interact with that of DSOs, which is also evolving.

Whilst we acknowledge Ofgem's intention of providing flexibility through a more 'principles-based' approach with regards to ESO regulation, we are keen to see the development of measureable outputs that match the ESO's responsibilities. For example, defining Key Performance Indicators (KPIs) would help provide all stakeholders with clarity of what the ESO is doing and why. These KPIs should differentiate between the ESO delivering its statutory duties and delivering additional customer benefits through innovation and efficiencies. To appropriately value any incentives and penalties greater visibility is required of the ESO's costs and how these align to delivering their forward plan. We would welcome the opportunity to discuss with Ofgem the role UK Power Networks and other network companies could have as part of this.

We do not support the proposed approach of weighting the incentive value to the seven ESO principles. This is because we believe these principles are too vague and do not accurately reflect the ESO's responsibilities. For example, principles 5 and 6 are on facilitating whole system

outcomes, which cross system boundaries; however, this is at a time when industry, for example through the Open Networks Project is working through the pros and cons of potential options on roles and responsibilities¹. Following the setting of RIIO-T2 we expect that the transition to a separate price control for the ESO should result in greater transparency of their proposed business plans and how this will interact with the running of our networks. We expect to be a key stakeholder in terms of ensuring their future business plans deliver whole system benefits.

We believe the ESO's stakeholder engagement will be a crucial factor in determining how successful they are at meeting customers' requirements going forward. Therefore, there must be a strong incentive for the ESO to do this well. We recommend that Ofgem align the approach it has used in RIIO-ED1 when considering the ESO's regulatory arrangements in this area. In terms of their performance to date, we have two major concerns of how they have engaged:

- 1) The ESO's evidence base to support their position on key decision areas is weak. For example, they currently state that the majority of stakeholders support a "layered/hybrid" funding model for the ESO in the future. However, we have attended various ESO workshops and would question whether there is indeed strong support at this stage. Additionally, in a stakeholder engagement report published by the ESO in August², the data presented on page seven, which is intended to support the ESO's above claims, is difficult to reconcile. We recommend Ofgem further examines this data to understand its validity and any conclusions that can be inferred from it.
- 2) In October the ESO published a mid-year report³ with a sub section on 'innovative connection solutions' they have been working on via tertiary windings in supergrid transformers. The ESO claimed in the report that "this is a great example of the ESO, the NGET and the DNOs working together on a whole system basis to find new and innovative ways to facilitate new customer connections." We would like to make it abundantly clear that the ESO did not engage with us whilst developing this solution with customers. We have since been discussing this with the ESO and NGET and have identified serious concerns with the approach they are taking and the impact it will have on the electricity distribution network and wider customers. This demonstrates the need for clarity around what a whole system approach is and why it is in customers' interests to have a common understanding of this. We have raised this issue with Katherine Taaffe and Chris Brown of Ofgem and will be following up separately with Ofgem to discuss further.

We believe it is vital that Ofgem does not preclude the most efficient arrangements from being realised in RIIO-2 and beyond by defining an ESO framework ahead of consulting on wider decisions e.g. on RIIO-T2 and RIIO-ED2. Importantly, we do not believe that the ESO's legal separation justifies in itself any expanded remit in terms of network planning and system operation at the distribution network level. Nevertheless, we are concerned that some of the proposals being put forward by the ESO in terms of their potential future role in delivering whole system outcomes lead to this expanded remit.

Through collaborative projects such as Power Potential we are already working closely with National Grid to understand and define interactions between the ESO and DSO. This 'learning by doing' approach is testing the merits of different approaches and will provide an evidence base to inform decisions on roles and responsibilities by Ofgem and BEIS.

¹ <http://www.energynetworks.org/electricity/futures/open-networks-project/future-worlds/future-worlds-consultation.html>

² <http://yourenergyfuture.nationalgrid.com/media/1518/eso-stakeholder-report-august-v1.pdf>

³ <https://www.nationalgrideso.com/sites/eso/files/documents/mid%20year%20report%20evidence%20chapters.pdf>

We support Ofgem's decision to appoint a Performance Panel to assess the ESO's progress against well-defined KPIs. This should include an evaluation of the ESO's stakeholder engagement performance and the processes they are deploying more broadly. In our recent response to Ofgem on your call for evidence on the ESO's Performance⁴ we flagged concerns we have on the ESO's engagement to date. Since then we have seen confirmation of the individuals that have been recruited to the ESO's Performance Panel and we are concerned by the lack of diversity of the membership group. The majority of Panel members appear to be already very familiar with National Grid's SO business, whereas we had expected more representation from new market players. Without this broader diversity of membership, there is a real risk that some groups are under-represented compared to others, resulting in the ESO not reflecting their needs adequately, which will make attaining a level playing field more challenging.

If you have any questions on the above or the feedback in the appendix, please do not hesitate to contact me in the first instance. As mentioned in this letter we would welcome the opportunity to meet with Ofgem to further discuss the regulatory framework for the ESO and particularly the issue of new connections being offered from tertiary windings.

Yours sincerely



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Daniel Saker, Distribution Policy Manager, UK Power Networks

⁴ https://www.ofgem.gov.uk/system/files/docs/2018/09/call_for_evidence_on_eso_performance.pdf