

By e-mail to: ESOpformance@ofgem.gov.uk

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Dear Grendon

ELEXON's response to your consultation on the evaluation process for the 2019-20 ESO regulatory and incentives framework

We welcome the opportunity to provide thoughts on potential changes to the evaluation process for the Electricity System Operator (ESO) regulatory and incentives framework from April 2019, as requested in your letter to stakeholders dated 14 February 2019.

As you are aware, ELEXON (as 'BSCCo') is the Code Manager for the Balancing and Settlement Code (BSC). We are responsible for managing and delivering the end-to-end services set out in the BSC and systems that support the BSC. ELEXON is also responsible for EMR settlement arrangements.

Under the BSC and EMR arrangements, we rely heavily on the ESO:

- for timely and accurate data in order, for example, to calculate imbalance prices
- for support in raising certain BSC Modifications e.g. those required to meet EU legal requirements
- for providing resource and information to enable certain BSC Modifications to be progressed and implemented in a timely and efficient manner.

In turn, ESO relies on both industry's and ELEXON's expertise and input, e.g. in developing the GB TERRE settlement arrangements and in widening Balancing Mechanism access; in developing harmonised imbalance settlement in Europe; and data for ESO to calculate TNUoS charges.

Therefore the design of the ESO regulatory and incentives framework is key for us, and important to the electricity industry and ultimately to end consumer, to the extent that this framework fosters or hinders cooperation and collaboration between the ESO and ELEXON.

The views expressed in this letter are those of ELEXON Ltd alone, and do not seek to represent those of the BSC Panel or Parties to the BSC.

I hope you find these thoughts helpful and if you would like to discuss any aspects, please do not hesitate to contact me at steve.wilkin@elxon.co.uk.

Yours sincerely,



Steve Wilkin
European Coordination Manager

ELEXON'S THOUGHTS ON ESO 2019-20 ESO REGULATORY & INCENTIVES FRAMEWORK

1. Ofgem's proposed changes to the evaluation process

- 1.1 In its consultation, Ofgem proposes that the evaluation moves from a 'per Principle' evaluation in 2018/19 to a 'per Role' evaluation for the 2019/2020 evaluation.
- 1.2 We can see several different aspects to this as follows.
 - 1.2.1 This move will give more flexibility to the ESO to allocate its resources and expenditure to areas where improvements will be most valuable to consumers. However, it will also give more flexibility to the ESO to allocate its resources where it is most cost-beneficial to ESO itself, i.e. to the easier or least costly to meet targets within each role.
 - For that reason we continue to support both ensuring that the overall incentive is addressed to maximise end consumer benefits and that there is transparency in the detail of ESO expenditure as was proposed by Ofgem in its earlier [call for input on the 2019-20 ESO regulatory and incentives framework](#). In [our response](#) dated 21 November 2018 we said:
 - 'We agree that additional reporting on ESO's internal expenditure would be helpful. This should reveal the strength of the incentives relative to base expenditure and will help decide if the strength of the incentives is appropriate, e.g. the relative size/weighting of the incentive pots; and indeed, in the longer term, whether the size of the overall incentive (currently +/- £30m) remains appropriate.' (We note that in January 2018, Ofgem assessed ESO's internal operational and capital expenditure costs¹ as around £140m per year. This would suggest the current incentive strength is around +/-21% of costs.)
 - The proposed change effectively changes the weighting given to each Principle, and means that they are no longer equally weighted. This is because we can look at the move to combine the Principles into Roles in a two/two/three combination as increasing the average weighting for Principles 1 to 4 to +/- £5m each (from £4.29m each); and decreasing the average weighting for Principles 5 to 7 to +/- £3.33m each (from £4.29m each).
 - In effect, this means ESO now gets a +/-£5m pot for Principle 4. We have previously suggested that such a strong financial incentive for improving ESO's code administration (part of Principle 4) is hard to justify.
 - In [our response](#) dated 16 March 2018 to Ofgem's consultation [on the draft ESORI arrangements Guidance Document](#) we asked whether consumer value is best achieved by paying the ESO to come up to the ELEXON 'best in class'² standard of code administration. We asked, and continue to ask, whether perhaps a better way to achieve the ELEXON standard from a value to consumer perspective might be simply to merge the ESO code administration function into ELEXON so that the

¹ [Ofgem Impact Assessment for the 2018/19 Regulatory Framework for the Electricity System Operator updated January 2018.](#)

² As evidenced by the results of both the first two Ofgem code administrator [2017](#) and [2018](#) surveys, published in April 2017 and October 2018 respectively.

ELEXON culture of excellence in code administration is assimilated more quickly and cheaply by the ESO code administration functions.

2. Other comments on the regulatory and incentives framework

Incentivising collaborative working

- 2.1 We believe that where collaboration is in the best interest of the consumer, the ESO incentives should be aligned with that and based on collaboration rather than competition.
- 2.2 So, although we do not necessarily agree that financially incentivising ESO to improve its code management is the best route to achieving those improvements, we do welcome the new metric in [ESO's draft Forward Plan for 2019-21](#). As this metric now appears to reward absolute improvements in ESO's code management, we think this is an improvement on the 2018-19 metric. The 2018/19 metric was based on relative improvements compared with other code managers. We believe that this effectively put ESO in competition with other code managers even when the industry and consumer interest was better served by partnership and collaboration.

Planning for, recognising and rewarding collaborative working

- 2.3 In [our response](#) dated 11 February 2019 to ESO's draft Forward Plan for 2019-21, we majored on collaboration. We noted the following points.
 - 2.3.1 'Coupled with engaging with wider stakeholders, including ELEXON, we would like to see ESO giving due credit/acknowledgement when achievements have been a joint effort or only made possible (at all, to time, to budget) with the support of stakeholders. This will serve to demonstrate that ESO are working with wider stakeholders, but also show the value and benefit of doing so. For example, in the recent thought leadership piece on widening access to the Balancing Mechanism (as part of BSC Modification P344 and beyond) a lot of the work was done by ELEXON, but was not recognised. If the ESO were to recognise the work done by ELEXON and how ESO had built upon it, it would have served to demonstrate that ESO are taking into account wider market developments and co-ordinated with others to the benefit of the whole market.
 - 2.3.2 Therefore we suggest that the ESO Forward Plan should set out the areas ESO will look to collaborate on, which stakeholders it will involve and how (deliverables and estimate of resource expected), and over what period. And then ESO should plan to monitor these collaborations and how well it planned for them.
 - 2.3.3 We also suggest a new ESO metric that shows the respective resource (man days) spent both by ESO and by its external collaborators on significant areas of work. This would help ESO, Ofgem and industry to understand the effort that is going into support its achievements, and by whom, and hence help ascertain the consumer value that is being added by external parties. This would allow greater visibility of performance and could facilitate incentive payments being better targeted.'
- 2.4 This lack of recognition for partnerships and collaboration was evidenced most recently by ESO's market-wide 'Future of Balancing Services Newsletter' email dated 28 February 2019.
 - 2.4.1 This included an article on widening Balancing Mechanism (BM) access where ELEXON's significant and vital contribution to ensuring wider BM access becomes a reality has been omitted. In effect this gives the impression that all the work was the ESO's and for which success they might be rewarded financially. The consumer interest, including financially, is best served if ESO reports its achievements transparently. The ESO should be incentivised to do so.

Energy Codes Review

- 2.5 Under the current BEIS/Ofgem Energy Codes Review, we believe that there should be a review of code funding. We believe that this should be across all code management and delivery and therefore that ESO's code management activities should be within the scope of this funding review.

END.