SP ENERGY NETWORKS

Network Planning & Regulation

Network Price Controls
Ofgem
10 South Colonnade,
Canary Wharf
London
E14 4PU

Date
5th July 2019

Contact / Extension
Stephanie Anderson
0141 614 1581

Dear colleague

RIIO-2 Sector Specific Methodology Decision and further consultation - Electricity System Operator

SP Transmission plc (SPT) welcomes the opportunity to respond to this decision and consultation. As a GB onshore transmission owner SPT has a strong relationship and engagement with the ESO to make our network available, allowing the ESO to balance the GB electricity system. We also provide key services in respect of network connections and investment planning. These arrangements are defined in the System Operator/Transmission owner industry code (the "STC").

Our view is that a partnership approach with the ESO provides the best outcomes for customers, stakeholders and consumers as our respective services typically work in tandem to deliver outputs. It is therefore important to us that the future ESO regulatory framework supports this approach. In respect of Ofgem's decisions on the ESO's regulatory framework we would like to make the following observations:

- The outputs and incentives the ESO will be delivering are established and assessed in a significantly different way from the network companies and is centered on an evaluative framework. It is important that this does not undermine the synergies with network companies that are essential to delivering customer satisfaction and consumer value. Ofgem maintain that the "*general spirit, though not the precise details , of the outputs and incentives messages set out in chapter 4 of the Core document continue to apply to the ESO"* (para 1.10).

- There is already a disconnection between the respective outputs of the ESO compared to the outputs we are delivering in RIIO-T1 and proposing in our business plans for RIIO-T2. There is no incentive on the ESO to engage and participate in developing alignment on outputs for the best interests of consumers. The separation of the ESO is important but should not be achieved to the detriment of existing partnership approach to delivering for consumers, particularly in the forthcoming price control period.

- We agree with the decision to retain a separate, standalone cost disallowance for Black Start incentives, based on the evolving nature of Black Start provision and significance of the costs.

- Continuing the principles-based approach provides a consistent development in the ESO regulatory model building on the changes and improvements from the previous arrangements and consistent with a separate ESO business.

- The two-year planning cycle is consistent with the historic Balancing Services Incentive Scheme (BSIS) so should not be an additional burden on the ESO, whilst providing suitable flexibility and accountability to respond to the rapid pace of change in the energy system transition. However, the framework does not appear to require the ESO to demonstrate their progress towards achieving the energy system transition in terms of key high level quantitative measures such as overall cost, system security and system flexibility. It is not clear yet how the Framework is ensuring consumer benefit is being delivered through the current set of metrics or activities. We also don't believe it is clear if system performance and security is improving, deteriorating or at risk if the credible future energy scenarios materialise. We believe it would be helpful for the ESO to develop appropriate metrics to evidence these parameters. A balanced scorecard approach would be appropriate.

  This view seems to be supported by the ESO Performance Panel which states in its 2018/19 report[1]:

  > "*Panel members also noted an improvement in the evidence of consumer benefits, but considered that the ESO needs to improve the demonstration of these benefits against a reasonable counterfactual in order to demonstrate the delivery of additional consumer value." (page 4, para 3)*
  >
  > *"It was noted that metrics should focus more on the strategic outcomes to be gained from the deliverables. The panel placed less weighting on the ESO's performance against the metrics due to these concerns." (page 4, para 4).*

In respect of the ESO role to facilitate competition in networks, the ESO has a unique position to bridge the gap between market solutions and infrastructure solutions to meet system needs. It is not clear that the regulatory framework sufficiently recognises this value add proposition due to a misguided focus on a facilitation role such as delivering tenders, which we consider inappropriate, given the ESO's commercial responsibilities in operating the GB Balancing Market. The ESO needs to establish a robust methodology for assessing and comparing the life-cycle benefits to consumers of market and infrastructures based solutions. For example, the ability to determine the value to consumers of mitigating the risk of constraint costs of planned outages against the cost of providing an infrastructure solution. Similarly, the benefit of commercial solutions for voltage support compared to asset solutions.

The two alternative options for the funding model for the ESO will have significant bearing on the ability of the ESO to deliver the energy system transition. The potential future value of this to consumers is rightly reflected in Ofgem's proposals to provide an asymmetric incentive for the

[1] ESO Performance Panel's end of year evaluation of the ESO's performance during the 2018-19 regulatory year

ESO. This is undermined by the lack of clarity around disallowance of costs which could be viewed as a capped liability and drive unambitious behaviours in the ESO. However, the lack of an approach to full pass through of costs also presents a risk to consumers of inefficient spend albeit this is of a much lower scale compared to the risk of not achieving the benefits of a fully flexibility low carbon energy system.

We have provided our response to the consultation questions in the appendix below.

Yours sincerely

S. Anderson

Stephanie Anderson
RIIO-2 Policy and Economics Manager

Appendix 1 – Responses to Consultation Questions

ESOQ1: **Which funding model would most effectively remunerate the ESO and support its financeability? Would either model have any risks or unintended consequences that you can foresee? Are there other funding models you think would be more appropriate?**

Model 1 which includes a RAV element to fund capital over the longer term would appear to be more financeable and avoid the risk to consumers of volatility on these costs.

ESOQ2: **Is an additional return needed to reflect the potential risk of cost disallowance or other regulatory penalty? How would this additional return be best delivered – via a higher WACC or a margin on internal or external costs?**

The 'disallowance of costs' proposal is consistent with the approach proposed for network companies but needs to be clearly defined to mitigate the financeability risk it may present. If there is the perception of subjective removal of allowance by Ofgem ex-post the risk of investing could be too significant for shareholders to fund.

It is important that 'costs disallowance' does not becomes a similar tool to the enforcement action that Ofgem already have available to them. The threat of 'cost disallowance' that is not clearly defined and understood would result in an incentive that is not effective in this area. This could result in the benefit to consumers of the energy system transition being undermined.

ESOQ3: **Would a working capital facility adequately cover the full range of risks the ESO is exposed to in fulfilling its revenue collection activities (in relation to collecting TNUoS and BSUoS charges)?**

It is unclear from the evidence provided if there is any reason this would not be sufficient. However, the lack of an incentive is a risk to consumers as there is no incentive for the ESO to achieve efficient costs. If this could be subject to cost disallowance is to be set as an effective penalty this is an example of where it would need to be accurately applied and therefore fully defined in advance

ESOQ4: **Would the ESO require additional funding or regulatory mechanisms to be able to procure a working capital facility? Please explain your answer.**

It would seem to be essential to provide funding to the ESO as this is an additional service they are providing for the consumer.

ESOQ5: Do the benefits of retaining the ability to apply a downside incentives penalty outweigh the potential costs in terms of the impact on ESO financeability?

The benefits of an upside only incentive is appropriate for the ESO as the potential benefits to consumers of delivering the energy system transition as quickly and effectively as possible; retaining security of supply, delivering low carbon system and achieving this at an affordable level for consumers it paramount. The risk of not delivering these benefits by constraining the ESO from being ambitious and innovative due to an imbalanced risk/benefit proposition must be avoided.

SP House, 320 St Vincent Street, Glasgow. G2 5AD

Telephone: 0141 614 0008

www.spenergynetworks.co.uk