



Making a positive difference
for energy consumers

Direct Dial: 020 7901 7000

Email: ESOperformance@ofgem.gov.uk

Date: 7 January 2020

Dear Stakeholders,

Call for input on 2020-21 ESO regulatory and incentives framework

We would like your views on potential changes to the Electricity System Operator (ESO) regulatory and incentives framework from April 2020. In August 2019, we proposed streamlining the roles and principles framework for the RIIO-2 period by moving from four to three roles.¹ We consulted stakeholders on our thinking regarding the evolution of the roles and stakeholders agreed largely with the content of our proposals. They also agreed that these changes should be introduced early as a priority for the 2020-21 incentive scheme.²

We are now consulting on the consequent changes we would like to make to the two supporting guidance documents: the ESO Roles and Principles guidance and the Electricity System Operator Reporting and Incentives (ESORI) guidance document. The proposed changes would give effect to our decision to streamline the roles framework for the 2020-21 incentives year.

We are also proposing modest changes to the evaluation framework and reporting requirements based on stakeholder feedback and lessons learnt so far.

We would appreciate your views by 4 February 2020. All responses should be emailed to ESOperformance@ofgem.gov.uk

¹ https://www.ofgem.gov.uk/system/files/docs/2019/08/riio-2_methodology_for_the_electricity_system_operator_-_decision_and_further_consultation.pdf

² <https://www.ofgem.gov.uk/publications-and-updates/riio-2-financial-methodology-and-roles-framework-electricity-system-operator>

Background

The ESO regulatory and incentives framework was introduced in April 2018. It was designed to encourage the ESO to work flexibly with its stakeholders in order to maximise consumer benefits across the full spectrum of its activities. The framework is built around us being clear from the outset about the behaviours and outcomes we expect of the ESO; but it places the onus on the ESO to engage with stakeholders to identify how to best meet and exceed these expectations. It includes:

- A set of 'Roles and Principles' designed to set clear expectations about the baseline behaviours we expect from the ESO;
- A requirement on the ESO to engage with its stakeholders each year to produce a Forward Plan, which will include Performance Metrics to demonstrate how it will meet our expectations and add additional value for consumers;
- Regular performance reports published by the ESO;
- A new ESO Performance Panel, which will challenge the ESO on its plans, evaluate its performance and make recommendations to the Authority;
- A decision by the Authority at the end of each year to financially reward or penalise the ESO up to a maximum cap and floor of $\pm£30\text{m}$, informed by the ESO Performance Panel's recommendation, as well as other evidence collected throughout the year.

The ESO Roles and Principles guidance document supports the framework by describing the ESO's key activities and setting out our expectations for how these activities should be performed. It therefore should inform the ESO's forward plans and performance reports. The ESORI guidance document describes the key stages of the annual incentives process, including the evaluation criteria and guidance on how we will assess the ESO's performance.

Key proposed changes for 2020-21

We propose to make three sets of changes that will take effect from 1 April 2020:

- Streamlining the ESO roles framework from four to three;
- Streamlining how consumer benefits are considered as part of the evaluation criteria; and
- Introducing high-level reporting requirements related to ESO internal resources.

1. Streamlining the ESO roles framework from four to three

In August, we proposed streamlining the roles framework by moving from four to three roles.³ In particular, we considered that 'Facilitating whole systems outcomes' and 'Facilitating competitive markets' were more suited to describing expectations we had for the ESO across all of its roles, rather than defining groups of activities.

Our three proposed roles were: short term operations; market development and procurement; and network development and planning. We believed this approach would minimise the scope for overlap in the ESO's reporting and the evaluation process. We also believed this could facilitate a more tailored approach to the performance evaluation. This is because the proposed roles could be seen to deliver benefits over broadly different time horizons.

We consulted stakeholders on our thinking regarding the evolution of the ESO roles and principles framework. The majority of respondents agreed with our proposals to streamline the number of roles from four to three, and in particular, that facilitating whole system outcomes should be an expected behaviour across all roles. They felt this should help to provide clarity on expectations and help ensure the roles do not overlap.

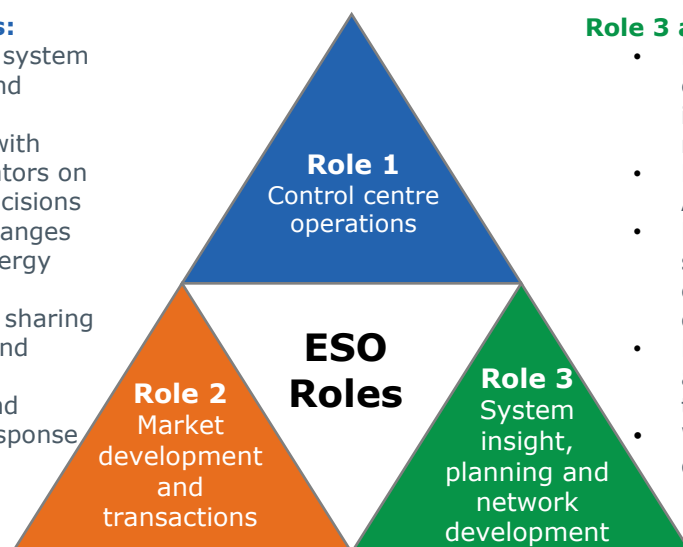
We have therefore decided to implement the streamlined ESO roles. These three roles are broadly the same as those proposed in August, but with small differences to their names to improve clarity. The three streamlined roles are: Role 1: Control centre operations, Role 2: Market development and transactions and Role 3: System insight, planning and network development.

³ See page 40 of our consultation document: https://www.ofgem.gov.uk/system/files/docs/2019/08/riio-2_methodology_for_the_electricity_system_operator_-_decision_and_further_consultation.pdf

Figure 1: Summary of the ESO roles and activities

Role 1 activities:

- Operating the system (monitoring and dispatch)
- Coordinating with network operators on operational decisions and outage changes
- Short term energy forecasting
- Managing and sharing system data and information
- Restoration and emergency response



Role 3 activities:

- Long term forecasting, energy scenarios and identification of network needs
- Network Options Assessment
- Delivering competitive system solutions and early network competition
- Managing connections and generator access to the network
- Whole system process development

Role 2 activities:

- Balancing and ancillary service market design
- Service procurement and settlement
- Revenue collection
- Policy advice and delivery of market framework changes
- Code administrator
- EMR Delivery Body

For the avoidance of doubt, no activities or expectations included against each of the previous roles have been removed. They have instead been re-categorised to the most appropriate of the three streamlined roles. For further details, please refer to the ESO Roles and Principles guidance document published alongside this letter.

2. Streamlining how consumer benefits are considered as part of the evaluation criteria

The ESO's performance is currently evaluated using the following predefined evaluation criteria:

- a) Evidence of delivered benefits
- b) Evidence of future benefits / progress against longer term initiatives
- c) Stakeholder views
- d) Plan delivery
- e) Outturn performance metrics and justifications

These criteria were designed to be considered together in order to establish an overall picture of the ESO's performance. They have no explicit weighting, and the panel can use its judgement to consider which of the criteria is more relevant to each role.

Our experience in practice is that the ESO's roles vary in nature. This means that the focus of the evaluation for each role has also been different in practice. Through our experience to date, we have found there to be some duplication in the ESO's reports as it has reported against evidence of delivered benefits and future benefits separately, when in reality there is a link between the two. We think it would help to streamline the ESO's performance reports if the criteria on delivered and future benefits could be merged. In August, we proposed streamlining the evaluation criteria and some stakeholders suggested that these changes could be introduced early for 2020-21. Therefore we have proposed some amendments to the ESORI guidance document to merge criteria (a) and (b).

3. Additional reporting requirements

Currently the ESO structures its reports per 'role area'⁴. In order to implement the changes to the roles framework described above, the ESO will be permitted to structure its Forward plan and performance reports by the roles defined above and as depicted in Figure 1. The ESO should continue to ensure that it considers the ESO Roles and Principles guidance document for each role.

Stakeholders and the ESO Performance Panel also expressed the view that they would like further information on the ESO's costs.⁵ Therefore, we have proposed a reporting requirement in the ESORI guidance document for the ESO to report on its internal costs for each role in the Forward Plan and in the end of year performance report. This will help to inform stakeholders' views on whether the ESO is using its resources efficiently and effectively prioritising the right areas. It will also inform stakeholders' views on the extent to which the ESO is being genuinely ambitious in its plans and investing to unlock additional consumer benefits. We recognise this is an additional reporting requirement and may require additional resources from the ESO to provide this in a timely manner. We would therefore appreciate views on how to best meet the industry's and the panel's expectations on this and we will be engaging with the ESO in particular on this.

Next steps

We welcome stakeholder views on the proposed changes to the guidance documents by 4 February 2020. We would also welcome views on any other aspects of the incentive framework. Please submit your responses to ESOperformance@ofgem.gov.uk.

⁴ 'Role area' refers to the three groups of principles, each with a separate evaluation process:

- Role 1 evaluation considers principles 1 and 2
- Role 2 evaluation considers principles 3 and 4
- Role 3 & 4 evaluation considers principles 5, 6 and 7

⁵ https://www.ofgem.gov.uk/system/files/docs/2018/10/call_for_input_on_2019-20_eso_incentives_framework_final.pdf

Once we have assessed the responses, we will be publishing our decision on the incentives framework for 2020-21 by March 2020. We will also publish the updated guidance documents alongside this decision.

If you have any questions on the contents of this letter, please contact us at the email address above.

Yours sincerely,

Maryam Khan

Senior Manager, ESO Regulation