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Dear Julie,

## **Call for Evidence on the Electricity Transmission, Gas Transmission, Gas Distribution and Electricity System Operator Business Plans for RIIO-2 – Whole systems**

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

This aspect of our response focuses on issues particular to the Electricity System Operator (ESO). We highlight the following point having reviewed ESO's business plan. In summary:

- **The ESO has been responsive to stakeholder views when developing its business plan.**
- **A full contingency plan for the IT-related transformational activities should be published.**
- **Transferring the revenue collection risk away from the ESO assists its attractiveness as an equity proposition.**
- **Some proposed metrics and performance benchmarks should be revised.**

### **The ESO has been responsive to stakeholder views when developing its business plan:**

We acknowledge the efforts of the ESO to take account of stakeholders' views when developing its plan. For example, we recommended the ESO should include a programmed delivery plan in its business plan, which has been done. Also, we stated the ESO has not justified why it should assume responsibility for the development and management of the Capacity Market Rules<sup>1</sup>. This activity is no longer proposed.

### **A full contingency plan for the IT-related transformational activities should be published:**

The ESO's business plan comprises several IT-related transformational activities to support its RIIO-2 outcomes, including the upgrade of legacy IT systems and the development of a platform

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<sup>1</sup> In our response to the ESO's RIIO-2 Ambition consultation  
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for the day-ahead procurement of system management services. A significant portion of the ESO's 'internal' expenditure over the RIIO-2 period is allocated to IT-related transformational activities. The scale becomes clearer when the funding requirement for IT-related transformational activities is compared to the overall level of expenditure over the RIIO-2 period. The ESO proposes to spend £337m on these activities - 41% of total funding for IT and 26% of the total funding requirement.

Table 1 - Transformational IT expenditure<sup>2</sup>

	2021/22	2022/23	2023/24	2024/25	2025/26	% year
Transformational IT expenditure	48.0	62.8	80.3	75.5	70.1	336.7
Total IT expenditure	165.4	157.6	168.2	164.1	159.5	814.8
Total expenditure	259.2	255.0	264.8	261.2	252.4	1292.6
Transformational IT expenditure						
...as a % of total IT expenditure	29%	40%	48%	46%	44%	41%
...as a % of total expenditure	19%	25%	30%	29%	28%	26%

We do not assume the successful completion of IT investment of this scale will be entirely straightforward, especially given the complexity and interdependencies between deliverables. Also, the transformational activities will be delivered alongside the operation of the system. This means the risks associated with both the delivery of the transformational projects and operation of the system need to be very carefully managed.

The ESO has identified several portfolio level risks and how those risks might be managed<sup>3</sup>. Though the ESO identifies how each individual risk could be managed, the ESO has not explained the impact on delivery and interdependencies (e.g. scheduling) if a risk materialises, whether some outputs may need to be prioritised and how resources could be refocussed. We think the ESO should publish a full contingency plan, which would enable market participants to better plan investments for delivering system balancing services.

**Transferring the revenue collection risk away from the ESO assists its attractiveness as an equity proposition.**

The ESO needs to be an attractive equity proposition. All other things being equal, the proposal allocate the Transmission Network Use of System (TNUoS) revenue collection risk away from the ESO, if implemented, could maintain the ESO being an attractive equity proposition even at a lower credit rating because the degree of risk to which it would be exposed has been reduced.

<sup>2</sup> Data taken from "ESO RIIO-2 Business Plan Annex 1 – Supporting Information". See: <https://www.nationalgrideso.com/document/158056/download>.

<sup>3</sup> "ESO RIIO-2 Business Plan Annex 4 – Technology investment report"; appendix C: <https://www.nationalgrideso.com/document/158071/download>.

Also, the working capital facility (WCF) requirement could be reduced– the ESO states the WCF requirement could be reduced by £300m if the proposal is implemented<sup>4</sup>.

**Some proposed metrics and performance benchmarks should be revised:**

The ESO has proposed metrics and benchmarks against which its performance over the RIIO-2 price control should be measured. We have identified some metrics are unlikely to capture genuine performance (e.g. metric 16 – proportion of shareable data published), that overlap with other benchmarks (e.g. metric 12 – future balancing costs saved by operability solutions) or should be expanded (e.g. metric 6 – proportion of balancing services procured through competitive means). Also, we identified some performance benchmarks that are insufficiently challenging and do not appear to align with the ESO’s level of ambition for the RIIO-2 price control. These are discussed in the attached appendix.

We hope you find these comments helpful. Please contact me if you have any questions.

Yours sincerely,

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Head of Network Regulation, Industry Transformation, Investigations and Governance  
**Centrica Regulatory Affairs, UK & Ireland**

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<sup>4</sup> “ESO RIIO-2 Business Plan Annex 5 – Finance report”; page 18:  
<https://www.nationalgrideso.com/document/158076/download>.  
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## **Appendix:** **Centrica's assessment of proposed metrics and performance benchmarks**

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### **Metric 1: Balancing cost management**

We agree with the ESO's justification for continuing to measure performance in this area in RIIO-2 - the efficient management of balancing costs is part of the ESO's core role and can be used to help assess performance in all areas.

#### *Calculating the annual benchmark:*

For the 2018-19, 2019-20 and 2020-21 scheme years, we recommended the cost benchmark should be a simple average of expenditure over the past five years, compared to the ESO's approach which involves deriving the cost benchmark from the linear trend through five-year moving averages. The simple average is preferable because it captures expenditure caused by a broad range of operating situations but without placing disproportionate weight on any set of circumstances.

Ofgem also has previously raised concerns about the ESO's approach and has now stated its "...end of year incentives decision will rely on the 5-year historic average of costs as a benchmark for balancing costs..."<sup>5</sup>. This may be an area in which Ofgem could consider setting 'core' metrics.

#### *Historic data range for the annual benchmark:*

The ESO has not proposed the data range to be used to derive each benchmark. For a relevant year, the data range should include the previous year since the range of operating situations that occur during the previous year should more closely align to that expected to occur during the relevant year. This means the benchmark for a relevant year cannot be set ahead of the start of that year. A provisional benchmark could be derived using available out-turn expenditure along with a forecast of expenditure over the remainder of the previous year. The benchmark would then be finalised once all out-turn data are available. We note the National Audit Office stated a key reason why consumer value has been lost in the current (RIIO-1) price controls is due to insufficient weight being placed on the most recent data when setting targets for incentive mechanisms<sup>6</sup>.

#### *Governance of adjustments to the annual benchmark:*

Adjustments to the benchmark are appropriate, to capture the impact of those extraordinary factors that would not be reflected in the historic averages. Examples would be an upward adjustment to the benchmark for expenditure on the accelerated Loss of Mains Programme and a subsequent downward adjustment to capture the expenditure benefits of the Programme. We recommend a framework for governing adjustments is developed. Among other things, the framework should include eligibility criteria and authorisation.

#### *Day ahead benchmark:*

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<sup>5</sup> "Ofgem response to National Grid Electricity System Operator's consultation on the ESO Forward Plan 2020-21"; pages 7-8:

[https://www.ofgem.gov.uk/system/files/docs/2020/02/ofgem\\_response\\_to\\_eso\\_draft\\_forward\\_plan\\_2020-21.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/02/ofgem_response_to_eso_draft_forward_plan_2020-21.pdf).

<sup>6</sup> See: <https://www.nao.org.uk/wp-content/uploads/2020/01/Electricity-networks.pdf>.

We welcome the ESO's proposal to compare expenditure estimated the day ahead to out-turn values and to explain the differences. This should greater transparency of the ESO's decision-making processes.

### **Metric 3: Day ahead demand forecasting accuracy**

We agree with the ESO's justification for continuing to measure performance in this area in RIIO-2 - accurate forecasting ultimately reduces bills for consumers and ensures system security and reliability.

#### *Effectiveness of the performance benchmarks:*

Although we support the use of this metric, we continue to believe the performance benchmarks for are not appropriate. The ESO proposes baseline performance is meeting monthly targets in six to eight months of the year for the monthly measure. We do not believe the proposed metric will necessarily be effective in encouraging focus across the entire year. For example, if forecasting accuracy is below the pre-defined threshold in the first eight months of the year, the metric is unlikely to encourage the ESO to improve performance over the remainder of the year since the baseline benchmark can never be met.

For the annual measure, the ESO proposes a 5% improvement on the previous year. It is unclear whether this target is ambitious because historic data have not been presented.

We note Ofgem commented on this issue in its response to the draft 2019-21 Forward Plan<sup>7</sup>, in its Formal Opinion<sup>8</sup> and in its response to the 2020-21 Forward Plan<sup>9</sup>. This may be an area in which Ofgem could consider setting 'core' metrics.

#### *Performance measures:*

The proposed performance metric for demand forecasting accuracy is based on absolute volume errors. We disagree with this approach. Performance should be independent of the level of demand on the system and targets based on absolute volume errors distort the underlying level of performance. For example, absolute volume targets based on historic years when demand was higher (primarily due to lower levels of embedded generation) are inappropriate because absolute volume targets would translate into weaker percentage targets.

We recommend forecasting accuracy is measured based on the mean absolute percentage error (MAPE). The ESO explains it "*...not believe this provides the correct incentive on our forecasting activities because it would incentive us to focus on demand forecast errors at times of lowest demand, rather than trying to minimise errors consistently across the day...*"<sup>10</sup>. We disagree. We think the MAPE would encourage the ESO to minimise errors consistently across the day since

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<sup>7</sup> 'Ofgem response to National Grid Electricity System Operator's consultation on the ESO Forward Plan 2019-21', page 7:

[https://www.ofgem.gov.uk/system/files/docs/2019/03/ofgem\\_response\\_to\\_eso\\_forward\\_plan\\_2019-21\\_consultation.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/03/ofgem_response_to_eso_forward_plan_2019-21_consultation.pdf).

<sup>8</sup> 'Ofgem Formal Opinion on the Electricity System Operator (ESO) Forward Plan 2019-21', page 7:

[https://www.ofgem.gov.uk/system/files/docs/2019/05/ofgem\\_formal\\_opinion\\_on\\_eso\\_forward\\_plan\\_2019-21.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/05/ofgem_formal_opinion_on_eso_forward_plan_2019-21.pdf).

<sup>9</sup> 20-21 Plan

<sup>10</sup> "ESO RIIO-2 Business Plan Annex 7 – Metrics and measuring performance"; page 12:

<https://www.nationalgrideso.com/document/158086/download>.

performance across the whole day contributes to the measure. We propose the following performance benchmarks:

<b>Exceeds benchmark:</b>	This should represent a significant step-change improvement (e.g. 25%) in benchmark performance
<b>In line with benchmark:</b>	For each month, the MAPE over the past three years (with an appropriate 'dead band') should be used.
<b>Below benchmark:</b>	This should represent a significant step-change worsening (e.g. 25%) in benchmark performance

### **Metric 6 – Proportion of balancing services procured through competitive means**

We agree that performance in this area should be measured. We disagree with any service (such as mandatory frequency response) that is procured through a market open to only a subset of market participants but with no technical constraint on wider procurement being categorised as 'competitively procured'. We recommend the proposed metric is improved by:

- Expenditure should be reported on a more granular basis (e.g. the categories in the Monthly Balancing Services Summary report) rather than the five categories proposed.
- Volumes and numbers of contracts (both absolute number and total MW capacity) held that were not procured via competitive methods should be reported.
- Commentary on the changes in expenditure, volumes and the number of contracts across the categories should be included.

We are unable to comment on the appropriateness of the proposed targets. To do so, we would require the rationale for why targets are based on a single quarter and the relevant historic data.

### **Metric 12 – Future balancing costs saved by operability solutions:**

At this stage, we do not support this proposal. In principle, at any given point in time, we would expect the ESO to choose the most efficient option when multiple credible options exist. Therefore, savings in balancing costs that can be expected to materialise in the future should materialise at that future time. This means the best metric remains (metric 1) balancing cost management measured at that future point in time. Further, measuring performance against this metric relies on defining reliable counterfactual scenarios, which may not always be possible.

### **Metric 16 – Proportion of shareable data published:**

At this stage, it is unclear whether there is merit in the ESO performance in this area being measured. The ESO has not explained how it can meaningfully influence performance. In line with the 'presumed open' policy, we expect restrictions on publication by exception. If, for example, a data set is not published because of security risks, that data should not be published until it is declassified. That data set not being published as a result of security concerns or being published once declassified is not a reflection of the ESO's efforts.