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Sent by email to: Eilidh.alexander@ofgem.gov.uk

Dear Eilidh,

SO:TO Optimisation Governance Document- Consultation

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

We support the trialling of the SO:TO Optimisation Output Delivery Incentive (ODI). System balancing expenditure has increased from £945m in 2015 to £1,730m in 2020¹, and the underlying trend of increasing costs is expected to continue. The trial appears to be an extension of a mechanism that already exists that allows the Electricity System Operator (ESO) to compensate Scottish TOs for the costs of changing their outage plans (in order to reduce system balancing costs) at the ESO's request. We note the majority of the ex-ante funding provided to compensate the Scottish TOs was returned to consumers². Based on the publicly available information, it is unclear whether the funding returned to consumers reflected the effectiveness of the existing mechanism. Therefore, we welcome Ofgem investigating whether the regulatory framework can be adapted to encourage companies to seek ways of reducing system balancing costs, thereby delivering value for consumers.

Whilst we welcome the trial, we highlight two areas of the mechanism that could be strengthened in order to place greater emphasis on the delivery of consumer value:

- **The efficiency of the solutions should be demonstrated.**
- **Rewards available should reflect the overall reduction in costs to consumers.**

¹ Data taken from the Monthly Balancing Services Summaries reports. The costs exclude 'internal' costs and incentive rewards/penalties.

² All of the 2012/13, 2015/16 and 2016/17 funding was returned. 69% of the 2014/15 and 71% of the 2019/20 funding was returned. Data taken from the annual Determinations.

The efficiency of the solutions should be demonstrated:

The proposed arrangements should be strengthened to ensure that the solutions implemented are efficient. As explained in the consultation, the ESO will assess the efficiency of the costs of the solutions proposed by the TOs and the TOs will carry out the works as agreed if the costs are acceptable to the ESO³. It has not been explained which factors the ESO should take into consideration when assessing efficiency or how efficiency should be assessed. Also, the ESO should be required to demonstrate the efficiency of the funding the TOs will receive in the independent report it is required to provide the Authority with.

This risk is compounded because risk-sharing between the companies and consumers does not apply and expenditure will be recovered on a pass-through basis. Also, there is no explicit incentive on the ESO to challenge costs. This means the normal incentive arrangements for ensuring efficiency do not apply in this instance and the proposed arrangements could create the risk that consumers may be required to provide funding above efficient levels. The proposed arrangements can be strengthened by:

- Requiring the TOs be required to confirm there is no funding overlap when submitting solutions for consideration.
- Placing a requirement on the ESO to demonstrate why it considered the funding provided to the TOs to be efficient in the independent report it is required to provide the Authority with.
- Ofgem conducting a review of the ESO's assessment of the efficiency of the funding the TOs were provided with.
- Making it clear funding provided will be returned to consumers if a funding overlap is identified or costs associated with the solution when it was proposed were demonstrably inefficient.

Rewards available should reflect the overall reduction in costs to consumers:

Rewards available to the TOs should necessarily be commensurate with the overall consumer benefit realised. However, rewards available to the TOs during the trial periods are on the basis of ex-ante modelled constraint cost savings instead of actual savings. This may be pragmatic during the trial period while companies become more familiar with the arrangements and explore new opportunities to reduce constraint costs. However, if the ODI is extended beyond the trial period, rewards available to the TOs should be based on total costs savings (including the costs of the delivery of the solutions) instead of ex-ante modelled savings.

We hope you find these comments helpful. Answers to the consultation questions are included in the attached appendix. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
Head of Industry Transformation, Governance and Forecasting
Centrica Regulatory Affairs, UK & Ireland

³ Paragraph 2.7 of the consultation.
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Answers to consultation questions:

Question 1: Do you agree with the reporting requirements set in the governance document for the ETOs and the ESO including the details required, the scope of reporting and timing?

We agree with the reporting requirements placed on the TOs. The reporting requirements placed on the ESO should be expanded to include a requirement to demonstrate why it considered the funding it provided to the TOs to be efficient.

Question 4: Do you agree that this SOTO Optimisation ODI Governance Document should continue to be in place during the assessment period to avoid any gap in governance if the Authority were to agree to continue to roll out the incentive for the remainder of the PC?

We agree the SO:TO Optimisation ODI Governance Document should continue to be in place during the assessment period.