

Electricity System Framework / System Balancing
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DONG Energy response to the Future arrangements for the electricity system operator consultations

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DONG Energy is one of the leading energy groups in Northern Europe. Headquartered in Denmark, we have an interest in several European markets and cover a wide range of energy sector activities. In the UK, we are the market leading developer and operator of offshore wind farms, as well as a supplier focussed on flexibility and demand side response.

Our ref. Ofgem Response - Future of SO

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We appreciate the opportunity to respond to Ofgem's consultations on the Future arrangements for the electricity System Operator. We have responded to both the role and structure, and the regulatory and incentives framework consultations, in this response.

Future arrangements for the electricity System Operator: its role and structure

The role of the SO

1. What are your views on our proposed objectives for the SO?

We support the objectives you have proposed for the SO. We would also encourage that you consider creating another objective for the SO to explicitly handle the SO's role at the centre of the electricity system, and need to deal effectively and fairly with its direct customers, such as transmission connected generators, and users of the system, such as embedded generators and retail customers, who are impacted by the decisions and the way in which the SO operates. This objective could also reflect the SO's role as the central body with the most data on the electricity system, and a need to share that information effectively.

2. What are your views on our expectations for how the SO should seek to achieve these objectives?

Generally, we agree with your expectations in the key areas that you have set out – residual balancer, balancing services, industry codes and facilitating a

whole systems approach. We look forward to engaging with the SO to facilitate these changes and developments.

Our ref. Ofgem Response - Future of SO

3. *Do you agree with our proposals for what licence changes are needed to support these objectives?*

Broadly speaking, in most areas Ofgem has identified that no changes are required to the SO's licence objectives, and that the consultation, eventual decision, and changes to the incentive framework, will clarify the SO's objectives and what they need to achieve to meet those objectives.

We are concerned by this approach. The SO has had these licence objectives, and many stakeholders have previously identified and called for the changes set out in your consultation. If the SO's objectives are sufficient, then it is likely that these changes would have already happened.

This consultation does set a change in that Ofgem is now clarifying these objectives, but we are concerned that this is not a sustainable approach. For example, what happens if the SO does not meet these new clarified objectives? What approach would Ofgem consider? Would Ofgem look at further governance changes? Would Ofgem be looking at taking enforcement?

These clarified objectives may also not reflect the rapidly changing nature of the electricity system. In our view the role of the SO should be flexible and continue evolving, while handling external developments and ensuring there is continuity, stability and predictability. This will ensure it can stay at the forefront of driving, efficient, sustainable change and ensuring positive outcomes for users and consumers of electricity.

In our view the greater independence of the SO should mitigate these issues, but we would encourage you to view the SO's objectives holistically with their governance framework, and consider how and in what way will their SO meet their objectives, inclusive of your approach to the SO's incentives and the SO meeting their obligations.

As an example, you may take the view that higher level, principle based objectives may be an appropriate way to change the SO's licence. We view that such a change must be made considering the rest of the framework. In this example, we view that you may want to consider how the SO will meet these objectives, and what happens if you and the SO differ on your interpretation of those principles and your approach if in your view the SO does not meet those principles.

A more independent SO

1. *Do you agree that greater separation between NG's SO functions and the rest of the group is needed?*

The existing model within National Grid of a combined SO/TO has in many ways created synergies which benefits customers and consumers. For example, as a direct user of the transmission network in England and Wales we clearly see that National Grid uses operational measures, mainly a SO tool, and close coordination between their TO and SO businesses, to efficiently minimise the negative impact of outages. These outages are required for connecting customers or performing repairs. These synergies must continue, and should not disappear because of the institutional changes proposed. However, we agree that greater separation could be beneficial, and support the options you have outlined. We have set out our views on the additional measures in the question below.

2. *What are your views on the additional separation measures we are proposing?*

In our view it would be useful to show in further granularity the specific costs and benefits of your proposals, as well as any areas where the current synergies may be affected so they can be mitigated. This will give stakeholders more information upon which they can provide a view on your additional separation measures.

Besides, we view that the measures you propose will help the SO become more independent, but we urge that you also consider additional measures to enhance the SO's governance, and make it a more responsive, stakeholder orientated organisation.

There are several measures that we view you may want to consider:

- Ring-fencing or even full physical separation
- Ensuring stakeholders have more opportunities to engage with and guide the SO's work
- Review the SO's IT systems

Full Physical Separation

In our view, if your objective is to ensure that the SO is a separate identity, with its own independent culture, we view that the SO will eventually need to be fully ring-fenced or even physically separated from other parts of National Grid's business. We do not view this as a step that needs to be taken immediately; moving large organisations in short timescales can be difficult, and we would not want to see the SO compromised because of an office move. We view that

you should consider the specific costs, benefits, and impact of any ring fenced arrangement against having separate offices.

Our ref. Ofgem Response - Future of SO

Stakeholder Engagement

We view that the SO could more proactively shape the evolution of the electricity system, as well as become a more responsive stakeholder focussed organisation. In our view you may want to consider how the SO can reach out and effectively incorporate stakeholder feedback views, and streamline their engagement with stakeholders, especially considering the complexity of the electricity system, and that there currently many forums which industry engages through.

Overhaul of the SO's IT Systems

We understand your view that it would not be appropriate to separate the IT systems of the SO and other parts of National Grid's business, as these systems are midway through their expected lifecycle. However, as a customer of the SO, we have often experienced or encountered IT that is not customer focussed, and could be modernised. In our view the separation of the SO represents an opportunity for the SO to review its various IT systems, including the customer facing ones, and improve, upgrade and optimise them.

3. What are your views on our proposed approach for implementing these changes?

In our view your proposed approach seems sensible. We would like to see further steps setting out how and when stakeholders will have the opportunity to further engage in your programme of work covering the separation of the SO.

Next Steps

1. What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?

We would like to be more involved and understand the costs and benefits of such measures. As above, we would also like to see how and when stakeholders will get a chance to be further involved.

2. What further evidence should we consider in finalising our impact assessment of these proposals on the SO's roles and level of independence?

Your consultation sets out that you have considered the potential for a future Independent System Operator (ISO). However, it does not set out your expected costs and benefits, of a two-step move to an ISO (SO → MISO → ISO) against a straight move to an ISO (SO → ISO), and against the case you

have set out (SO→MISO). We view that these costs and benefits need to be made clear, especially if industry and the SO end up facing potentially two very significant changes.

Your position also highlights your view that a MISO is currently the right option. We suggest that to minimise the potential for another future, costly change from a MISO → ISO, you consider in what scenarios an ISO would be preferable to a MISO, and mitigate against those situations by enhancing your design of the MISO.

We would also recommend that if you perform any Cost-Benefit Analysis (CBA), that CBA does not count the costs and benefits of actions the SO / National Grid would have taken under a business as usual scenario. For example, IT systems need to be periodically reviewed and updated, and restructures happen naturally at a business such as National Grid's.

Future arrangements for the electricity System Operator: the incentives framework from April 2018

Background and objectives

1. *Do you agree with our objectives for the future SO regulatory framework? Are there any missing?*

We generally support the objectives you have set out. We view that it is appropriate the SO regulatory framework needs to reflect the balance between short term and future benefits. As we have set out above, we view that the SO's role with stakeholders and customers should be more explicit.

We have concerns on your objective to ensure create risks and rewards for the SO, especially in the context of maximising efficiency for the future electricity system. The electricity system is driven by substantial policy and infrastructure changes that take years, eg. smart meters, embedded generation, electricity market reform, electrical balancing system, etc., while the SO incentives have historically been set for short timescales eg. two years, for various reasons including the difficulty of forecasting long term balancing costs. This is a mismatch and we view that any incentives need to be applied carefully so that the right balance is achieved between short term and long term goals. Our view is that it might be more important to firstly ensure the appropriate governance exists for the SO, due to the difficulty of balancing short-term and long-term incentives for the SO.

2. *How can we best transition to a SO regulatory framework which meets these objectives? When should changes be made?*

We support your approach that aligning a more fundamental review of the SO regulatory framework with RIIO-T1 makes sense. We would caution that this

could lead to significant workloads for industry and Ofgem, and so would want to see plans put in place and any review started with a significant lead-time.

Review of the current framework

3. *What lessons can be learned from our previous approaches to regulating the SO? What are the key areas where changes might be needed in future?*

In our view any future regulatory framework should be considered against the areas where you and stakeholders view that the SO has not been sufficiently proactive, or the results have not been as efficiently incurred as they could have been. There are several areas that we can think of: recent black start costs, the procurement of ancillary services, code governance, etc.

We have highlighted key areas in previous responses we have submitted to you, and we have included some new areas that we view need to be considered:

- The SO's procurement of balancing services needs to be reviewed to ensure there is wider access to this market
- The SO's decision making and responsibilities in areas where there are SO-TO interfaces needs to be made explicit, and ensure that the SO takes the most efficient system approach, and not the approach that is most beneficial to the SO. One example would be the SO's provision and payments for reactive power, most notably on offshore networks where offshore wind farms providing and being paid for their reactive power can be an optimal solution
- The SO's IT systems
- The SO's approach to interacting and engaging with stakeholders

Future framework design

4. *Do you believe we need to introduce more clarity about what we expect from the SO under its obligations? How should this clarity be provided? To what extent should we set prescriptive or principles-based requirements?*

Our views on this question are set out in our responses above.

5. *Should we place financial incentives on the SO? If so, in which areas? And what form should they take?*

As we have set out above, we are not sure how financial incentives have worked for the SO. In our limited experience we have seen that financial incentives can have an effect on SO behaviour, and would want to see any incentives carefully designed.

6. *Should we introduce more non-financial incentives on the SO? What approaches should be taken? Do you support the introduction of a set of KPIs, and if so, what should these KPIs be?*

We would be open to there being more non-financial incentives, though we recognise there is limited evidence and experience of the impact of non-financial incentives.

We would also be open to KPIs, though we would appreciate clarity over how KPIs would work if you move towards more principle-based regulation of the SO. We also view there needs to be more detail over how these KPIs would be designed. In-line with our earlier views on stakeholder engagement, we view that KPIs developed with industry may have a role in setting clear expectations over how the SO should operate, and what it could achieve.

Incentive scheme governance

7. *How should SO incentives be governed in the future? Would you support a greater role for stakeholders in this process? How can we introduce more transparency around incentives?*

As set out above, we view that stakeholders, and not just direct customers of the SO, should have a greater role in feeding in and providing views on the work of the SO.

One of the clear barriers to transparency under the current scheme is its complexity, and the lack of transparency around the SO's decision making, and the way in which this information is provided to stakeholders. As we suggested above, we view that there is a case for making explicit the SO's responsibilities to disseminate information, possibly through the licence, another obligation, or through KPIs, will increase transparency of the scheme.

If you have any questions on our response please feel free to contact me (almos@dongenergy.co.uk, 020 7811 1055).

Yours sincerely

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