System Balancing
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10 March 2017

Future arrangements for the electricity System Operator: the regulatory and incentives framework

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

The role of the System Operator is changing and becoming more challenging as the sector decarbonises, with less flexible grid connected generators, more intermittent generation, growing interconnection, significant growth in decentralised energy resources, along with new technologies such as storage, series compensation and HVDC circuits, and an increasing role for active consumer participation.

The System Operator must be effectively incentivised in this changing world to undertake its role in a robust and low cost manner to ensure that consumers continue to receive reliable energy supplies at least cost.

To achieve this we consider that the System Operator should be doing more to provide a clear vision to the market of the scale and scope of services it will need into the future, and evolving their procurement model both in terms of the method but also the products. We find the current procurement arrangements segmented, complex and at times opaque. This risks inefficiencies borne out by recent experiences on black start procurement. We believe that some services are not being adequately signalled or valued, such as the provision of inertia. National Grid needs to develop a more effective procurement model that is transparent, market wide and technology neutral.

The future regulatory and incentives framework for the electricity System Operator is key to achieve these reforms. It will need to balance short and longer term incentives through an evolving energy system. The new framework must encourage the SO to focus on the outcomes it needs to deliver over a longer period, taking the whole system into account. In this regard, we believe Ofgem's initial review is well considered and we look forward to contributing towards designing the specific changes needed for the longer term incentive scheme.

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Separately we welcome BEIS, Ofgem and National Grid's joint Statement outlining their intentions to develop a more independent SO. The proposed changes outlined in the parallel consultation should create some of the building blocks necessary to help Ofgem achieve its objectives for the future SO regulatory framework.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or me.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Angela Hepworth
Corporate Policy and Regulation Director

Attachment

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EDF Energy's response to your questions

CHAPTER ONE: Background and objectives

Q1. Do you agree with our objectives for the future SO regulatory framework? Are there any missing?

Yes, the five objectives look broadly right.

Overall delivering the System Operator's role cost effectively taking into account whole system costs now and in the future underpins these objectives.

Ofgem highlight the importance of transparency and engagement – we strongly support the need for greater transparency in some areas of Grid's procurement and while National Grid reach out to industry through various forums, e.g. Summer/Winter Outlook, with an evolving system National Grid need to heavily build on the System Operability Framework document to better inform industry of medium term issues and opportunities. We also agree that there may be a valuable role for greater stakeholder engagement in helping to shape and evolve SO targets, particularly with the system is evolving, and assessing whether the expectations are achieved as part of the SO regulatory framework and incentives.

Q2. How can we best transition to a SO regulatory framework which meets these objectives? When should changes be made?

We welcome National Grid and Ofgem's intention to introduce improvements from April 2018 and having a "trial" period of new ways of working ahead of full consolidation in April 2021 to align with the beginning of RIIO-T2.

While we recognise the importance of the 2021 date, this is four years away and the need to act to improve the SO regulatory framework and incentives is apparent now. We urge Ofgem to take the necessary steps through 2017 to implement key reform from April 2018.

CHAPTER TWO: The current SO regulatory framework

n/a

CHAPTER THREE: Review of the current framework

Q3. 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?

By and large the SO incentive schemes have encouraged the System Operator to minimise short term costs for the industry and ultimately consumers and therefore have been successful. Where it has fared less well is encouraging trade-offs and investment to be made to reduce medium term costs of operating the system. This has been exacerbated by the pace of change on the system exposing some of these issues, e.g. black start procurement, growth in ROCOF costs to deal with low levels of inertia.

We agree with Ofgem that the design of the current balancing incentive scheme may encourage the SO to overly prioritise shorter term steps to reduce costs ahead of more innovative, longer term solutions. We would support future incentives on balancing costs to be better balanced with more focus on long run outcomes for consumers. This is particularly important as otherwise in the longer term the cost of balancing services are expected to grow significantly and could be volatile.

The benefits of having a regulatory framework that could expose the SO to types of reputational and financial risks and rewards that a company might face in a market place are well understood. However, the impact of any reputational risk for a company that will have greater separation from the rest of the National Grid Group of companies is unclear. In principle we support this approach and consider that benchmarking/ using similar KPIs to other ISOs internationally will be an important factor in making this a success. We also presume that financial risks resulting from poor performance will have an impact on the SO's credit rating. The implications of any poor rating on the SO (and National Grid Group) are also unclear with the plan for further separation and independence. It is important that the SO is incentivised but also financially secure.

In terms of Balancing Services Incentive Scheme (BSIS), we agree with most of the stakeholder views highlighted in the consultation. The current approach creates a strong incentive on the SO to take actions to incur less than BSIS targets but there is currently less incentive on the SO to factor in the implications these actions have on overall system efficiency, or wider network costs. This suggests that the SO needs to have a broader assessment of wider costs in making decisions on balancing services.

CHAPTER FOUR: Future framework design

Q4. 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?

Yes, it would be beneficial for Ofgem to set out clear expectations for what it is requiring the SO to achieve under its obligations. This clarity will also be helpful for other stakeholders to ensure expectations are aligned. Clarity can be provided through a combination of principles-based requirements supported by Ofgem guidance. There will, however, be some areas where there will still be a need for more detailed licence obligations.

Q5. Should we place financial incentives on the SO? If so, in which areas? And what form should they take?

In principle, we support having financial incentives on the SO as this is likely to provide the strongest incentive to deliver value for consumers. A mixture of both short term and long term financial incentives may be necessary depending on the action that needs to be incentivised. In activities that are relatively stable and can be modelled robustly, then financial incentives should be used to support least cost delivery and innovation.

Q6. 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?

Yes, we believe stakeholder engagement is a key behaviour needed for the SO to perform well in its roles. Strong stakeholder engagement will be vital for the SO to identify how procedures and arrangements need to evolve to drive competition, innovation and efficiency.

In principle, we support the idea of introducing KPIs. As outlined by Ofgem, this could involve developing a set of formal metrics to cover all the SO's roles in the system or benchmarking against other SOs.

CHAPTER FIVE: Incentive scheme governance

Q7. 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?

There is a need for a mixture of independent audits, a greater role for industry, use of panels and more holistic reporting across the SOs roles. Transparency will be key in all aspects – stakeholders must have confidence in any reporting and decision making and performance assessment.

EDF Energy
March 2017