SP ENERGY NETWORKS

Network Planning & Regulation

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Contact / Extension
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Dear David

Future arrangements for the electricity system operator: the Regulatory Incentives Framework.

We welcome the opportunity to comment on Ofgem's proposals to introduce further separation between National Grid's SO and TO functions as the proposals will have a direct impact for future onshore transmission arrangements and policy. Please read this response in conjunction with our parallel response to the consultation on the Future arrangements for the electricity system operator: its Role and structure.

SP Distribution plc, SP Manweb plc, and SP Transmission plc. ("the network companies") are the "asset-owner companies" holding Scottish Power's regulated assets and distribution and transmission licences. Scottish Power operates along divisional lines, and together, the activities of these companies fall within the Energy Networks division "SP Energy Networks" (SPEN). This response is from SP Transmission plc (SPT) the onshore Transmission Owner (TO) for the South of Scotland. As a TO we have a statutory duty to ensure that we develop an economic, efficient and coordinated onshore transmission system.

We have had a view for some time that the recent BSIS frameworks have been too focussed on short term commercial priorities rather than this primary priority. This has led to the SO's overarching responsibility to ensure an efficient, co-ordinated and economical system being subsumed to focus on short term commercial priorities over and above long term security of supply and reliability.

We therefore welcome the stated objective of the future regulatory framework, to maximise the efficiency of the whole electricity system, both now and in the future, and to achieve this through more principles based regulation. It is also important to ensure that there are diverse sources of Transmission expertise across the SOs and TOs to enable expert discussion of the technical issues. Current arrangements maintain that position, providing the regulator, the government and customers with an in depth technical quality assurance check on SO activity.

Please do not hesitate to contact me should you have any queries in relation to our response. We have addressed the questions posed in the above consultation in Appendix 1.

Yours sincerely,

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Appendix 1: Response to Consultation Questions

CHAPTER ONE: Background and objectives

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

The responsibility to ensure security of supply and the reliability of the transmission system must be the first priority of the GB system operator. We have considered for some time that the recent BSIS frameworks have been too focussed on short term commercial priorities rather than this primary priority. In light of this, we generally agree with the objectives for the proposed regulatory framework.

In particular we support the objective to maximise the efficiency of the whole electricity system both now and in the future. Short term arrangements do not allow full consideration of whole system costs, for example in relation to potential infrastructure design and delivery solutions that could mitigate overall outage constraints or consequences, for a small increase in capital cost. We have also been concerned that the short term framework can drive the wrong behaviours by the SO in the management of outages to focus on short term constraint savings, without due consideration of longer term benefits of maintenance or capital programmes. From a TO perspective, this can impact our ability to achieve the outages required to deliver our agreed capital programmes that will deliver increased system capability alleviating overall constraints, associated long term costs, and impact reliability and resilience.

We are also aware of the increasing difficulty to forecast potential constraint costs which is likely to undermine the benefit of a target based incentive. We agree that the increasing influence of intermittent and embedded generation on the operation of the transmission system, factors largely beyond the control of the SO, require a significant change to the existing incentive framework. For this reason we also support the objective for the SO to work closely with other network operators and DNOs in particular.

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

We support the proposal to have a long term incentive framework in place for April 2021. However, the arrangements for this period need to be in place well before that to inform the next price control for onshore TOs. We would suggest April 2019 as the latest date at which the details are finalised in principle.

CHAPTER TWO: The current SO regulatory framework
n/a

CHAPTER THREE: Review of the current framework

Question 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?

The annual value of BSIS costs at £850m demonstrates that lessons need to be learned. It would be helpful to have a comparison as to how this scale of payment compares with comparable international

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markets. The value of BSIS costs suggests improvements could be made in the wholesale market to improve balancing between providers to reduce the scale of residual balancing required and going forward we agree that the SO should consider this in a whole system approach.

As the cap and floor limits are regularly reached this also suggests the tools available to the SO to control costs are in place. In particular, the challenge of forecasting constraints accurately undermines the target based approach. The apparent difficulty in forecasting or identifying actual constraint costs associated with a specific circuit or outage also limits the ability to make investment decisions in advance.

CHAPTER FOUR: Future framework design

Question 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?

The "principles based regulation" described in chapter 4 does present a positive approach to the future incentive framework. The complexity and uncertainty associated with managing the transmission system requires flexibility, responsibility and experience. A rules based approach could not fully achieve this, and appropriate targets could be established for example planning for system shutdown and restoration within timescales minimising damage to the economy.

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

It is not clear from the lessons learned from the existing frameworks that an incentive based approach is effective. The conclusions in para 4.18 promotes a discretionary approach to incentivising the role of the SO going forward. We would agree a discretionary approach seems more beneficial and should allow a clear focus on system security and reliability to dominate over a short term commercial self-interest.

Question 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?

The example of ISOs in the United States is very helpful. An SO with short term commercial self-interest as its primary priority is less likely to achieve longer term whole system objectives as effectively as a non-profit organisation measured against prescriptive key performance measures. These could act as strong incentives such as a time limit to restore supplies after widespread disruption, which in turn would influence critical spares policy, and planning for a system black start which in turn would influence relevant markets.

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CHAPTER FIVE: Incentive scheme governance

Question 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?

We agree the regulatory framework should encourage the SO to focus on the outcomes it needs to deliver as stated in para 5.3. We also agree governance is important to achieve this.

The suggestion to use quality assurance of forecasting models is appropriate, but the real issue is the ability for the model to accurately set targets for incentives. We are not convinced that targets are the right way forward.

If a more discretionary approach to the incentive framework is adopted, the use of industry panels and independent experts will be valuable. The objectives of the SO to deliver system resilience and quality of supply whilst minimising costs could be facilitated by setting appropriate KPIs and having these assessed by experts and stakeholder with knowledge and expertise in that area.

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