

2018-19 Mid-Year Review Report of the Electricity System Operator's Performance

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Overview

We introduced a new regulatory and incentives framework for the Electricity System Operator (ESO) in April 2018. Under the new arrangements, the ESO must engage with its stakeholders and publish a forward plan before the start of each regulatory year. This forward plan should outline the key actions the ESO intends to take to maximise benefits for consumers and to meet the expectations described under our seven principles. The ESO will then report on its performance and provide evidence throughout the year. The ESO Performance Panel plays a central role in this new framework. It will challenge the ESO's plans before the start of the year, evaluate its performance after six months (the 'mid-year review') and then perform a final evaluation at the end of the year. This forms a recommendation to the Authority on the financial reward or penalty.

In November we held the first mid-year review session on the ESO's performance.

We are publishing this report as the secretariat for the panel, detailing the panel's assessment of the ESO's performance at the mid-year review stage.

Introduction

Overview of process

As part of our ESO regulatory and incentives framework, the mid-year review forms an opportunity to assess the ESO's performance over the first six months of the incentive year. Our framework requires the ESO to produce and publish a report covering its performance during the first and second quarter.¹ The aim of this is to update stakeholders on the progress the ESO has made against its deliverables; its explanations for its outturn performance against its performance metrics; and the evidence of consumer benefits it has delivered or expects to be delivered in future. Following the publication of the mid-year report, the ESO presents its evidence contained in the report to stakeholders and the performance panel. The panel considers this evidence and evaluates the ESO's performance, highlighting areas of good performance and any areas of concern that should be tackled over the remaining months of the year.

Mid-year Review

The first mid-year review meeting was held on 20 November 2018 in London. The day consisted of an open morning session for the ESO to provide an overview of its mid-year report, setting out its view on its performance to date with any justifications and evidence. Stakeholders also had the opportunity to raise questions and provide direct feedback to the ESO. The afternoon session was an opportunity for the panel to directly question or seek clarification with the ESO.²

On the 29 November, the panel convened again to make its assessment of the ESO's performance over the first six months of the year. The panel used the evaluation criteria below to provide **mid-year scores** for each of the principles. For the avoidance of doubt, the scores do not determine an incentive reward or penalty at this stage. These scores are indicative and are to inform the ESO on the areas that it is performing well and the areas where improvements need to be made over the final six months of the year.³

This report summarises the panel's assessment of the ESO's performance to date and some wider considerations to inform the ESO's Forward Plan and its performance reporting for future years.

The evaluation criteria

In determining a score for each principle, the performance panel used five key considerations to evaluate the ESO's performance:

- a) Evidence of delivered benefits
- b) Evidence of future benefits / progress against longer term initiatives
- c) Stakeholder views
- d) Plan delivery
- e) Outturn performance metrics and justifications

¹ The ESO's mid-year report can be found here:

<https://www.nationalgrideso.com/about-us/incentives/eso-incentive-performance-and-reporting>

² The slides from the morning session can be found: https://www.ofgem.gov.uk/system/files/docs/2018/11/mid-year_review_morning_session.pdf

³ More details on the scoring and evaluation criteria can be found in Chapter 3 of the ESORI guidance document: https://www.ofgem.gov.uk/system/files/docs/2018/03/esori_arrangements_guidance_document.pdf

Scoring

For *each* of the seven principles, the performance panel have provided *mid-year* scores for the ESO on a scale of 1 to 5, where:

- 1 = Weak
- 2 = Poor
- 3 = Average ('baseline expectations')
- 4 = Good
- 5 = Excellent

Summary of ESO Performance Panel's assessment

Approach

The panel used the evaluation criteria described above to assess the ESO's performance in relation to each principle, taking into account Ofgem's feedback in the formal opinion and stakeholder feedback collected to date. To facilitate the discussion, the panel initially applied an equal weighting to the five evaluation criteria. In some cases, however, panel members placed greater emphasis on specific criterion for a principle.⁴ The panel noted that some of the principles tended to be geared towards activities that deliver future benefits (eg Principle 5, Principle 6 and Principle 7) and as a result, it was noted that a greater weighting towards evidence of future benefits may be more appropriate in those areas.

Panel members noted a significant lack of identifiable evidence of specific consumer benefits, especially when it came to expected future benefits. However, they also recognised that this is the first year of a markedly different process and the difficulty the ESO may have in providing quantified evidence for some of the principles and activities, particularly when the expected benefits are diffused and uncertain in timing, amount and value. In considering (a) and (b) of the evaluation criteria, for example, panel members differed in their approach. Those panel members that scored lower generally placed more of an onus on seeing tangible outputs and clear evidence of activities delivered in practice that have delivered current benefits, or will deliver benefits in the future. Other members were more willing to give the ESO credit for setting out how ongoing activities have delivered current benefits, or will deliver benefits in the future. The panel stressed that, at the end of the year stage, scores (and therefore financial rewards) cannot be awarded based on assumptions by the panel. The panel therefore called for the ESO to provide clear and focussed evidence and narrative at the end year stage, particularly on future benefits.

The valuation of future benefits created particularly difficult problems for the panel. More thought should be given to this issue, not least by the ESO, especially when the framework comes to be used in the context of determining financial rewards and penalties.

Overarching messages

Overall the panel reflected that in coming to their respective conclusions, they had difficulty in assimilating the amount of information provided by the ESO.

⁴ In line with guidance from Ofgem:
https://www.ofgem.gov.uk/system/files/docs/2018/03/esori_arrangements_guidance_document.pdf

The panel encouraged the ESO to provide a more focussed assessment of performance at the end of year stage which should identify:

- the benefits the ESO considers have been delivered during the assessment period;
- the extent of future benefits that the ESO considers will arise from initiatives progressed during the assessment period;
- tabular information on progress against the forward plan, performance metrics and more examples of historic trends; and
- the improvements made in response to Ofgem’s feedback.

For some of the principles, the panel noted that the ESO’s evidence contained significant narrative around ongoing work but sometimes only limited tangible evidence of outputs delivered between 1 April and 30 September. As the reporting relates to the first 6 months of the new approach, and many deliverables for this first year are due in the second half of the year, the panel considered that this may not be not surprising. In some areas good foundations have been set and the panel looked forward to seeing clear progress over the remainder of the year. The panel encouraged the ESO to focus its future evidence more on how these initiatives have delivered tangible benefits for consumers now and in the future.

The panel further considered that a lot of the evidence provided related to initiatives that were more consistent with baseline expectations for the ESO, including delivering activities required under their existing licence obligations. In particular, reports could better distinguish between baseline deliverables and those that are clearly exceeding expectations. Where possible, this distinction should be agreed with stakeholders, the panel and Ofgem at the beginning of the year and included in the forward plan; notwithstanding the need for the ESO to remain open to identifying new opportunities for delivering benefits that arise during the year. A particular point in this regard is that the ESO should clearly identify – with focussed evidence – whether and when the baseline deliverables in their plan include expected lower costs and/or additional benefits relative to past performance. The ESO will only be eligible for incentive payments if it can demonstrate that its performance is exceeding baseline expectations.

The panel agreed that there is significant scope for the ESO to improve the performance metrics to ensure that they are stretching and outcomes-focussed. This relates to both the scope of the metrics and the targets set.

Summary table of scores

We have summarised the scores agreed by the panel, following their assessment of the ESO’s performance. As this is the mid-year review stage, these scores are indicative and are to inform the ESO on the areas where it is performing well and the areas where improvements need to be made over the next six months. For the avoidance of doubt, these scores do not determine an incentive reward or penalty at this stage. The final scores awarded at the end of the year form the recommendation to the Authority on incentives.

Principle	Principle 1	Principle 2	Principle 3	Principle 4	Principle 5	Principle 6	Principle 7
Score	2-4	2	3	2-3	3	3	3

Specific feedback from the panel in relation to each principle is listed below.⁵

⁵ More information on our expectations for each principle can be found here: https://www.ofgem.gov.uk/system/files/docs/2018/02/eso_roles_and_principles.pdf

Principle 1 - Support market participants to make informed decisions by providing user-friendly, comprehensive and accurate information

This principle requires the ESO to improve information provision and to increase transparency in order to help market participants make informed decisions.

Mid-year score	2-4
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There were a range of views for this principle with scores between 2-4.

- Some panel members considered an overall score of 4 was merited, placing particular weight on the evidence of delivered consumer benefits in this area. They highlighted anticipated consumer benefits associated with the new solar photovoltaic forecasting tool and the carbon intensity platform, as well as potential benefits from improvements to the balancing cost information and the introduction of tender webinars. They also noted the positive stakeholder feedback associated with engagement around the Future Energy Scenarios – with positive comments around the distribution/transmission based scenarios. Some members also felt that the ESO should be given credit for ongoing work that could deliver potential future consumer benefits.
- Other members felt that whilst the ESO had made improvements and improved outcomes, at this stage, these improvements did not clearly go beyond baseline expectations under the principle. One member considered the ESO’s performance merited a score of 2 because there had not been sufficient tangible evidence of progress made since 1 April against the expectations described under the principle and the ESO’s stated vision. In general, members felt the ESO needed to deliver more tangible changes to the way it provides information on its current and future system balancing activity, noting stakeholder feedback in this area.
- Further improvements that were suggested for the remainder of the year included more transparency around future Balancing Services Use of System (BSUoS) charges, more accessible information on balancing actions and bilateral trades that have been taken by the ESO (discussed further under Principle 3), more information on the ESO’s plans to deal with system operability challenges (noting the reduced information surrounding the System Operability Framework), and more consistency and less fragmentation between published information in general. It was also noted that as a default the ESO should be fully transparent in providing information to the sector and there should be clear justifications for not publishing any information requested by industry.
- In general, it was felt that the ESO had significant scope and capability to make further changes to the information it provides. It could be doing more to coordinate effectively with relevant stakeholders to deliver platform changes that help provide the most efficient and accessible end-to-end solutions for market participants.

Principle 2 - Drive overall efficiency and transparency in balancing, taking into account impacts of ESO actions across time horizons

This principle focusses on the ESO's role in the Balancing Mechanism (BM) and in ancillary service markets. It requires the ESO to take the most economic action that solves the system's balancing and/or operability need in order to efficiently maintain system balance, deal with system operability issues and network constraints. We expect the ESO to do this by striking an appropriate balance between short-term reductions in balancing costs and the longer-term development of balancing services markets.

Mid-year score	2
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After discussion, the panel reached a consensus score of 2.

- The panel considered balancing costs to be a critical area of consumer value and noted that overall costs were tracking above the benchmark set under Metric 5. Panel members recognised that balancing costs can be subject to factors outside of the ESO's control, but felt that in this instance, insufficient justification was presented to suggest higher than expected costs were all down to factors beyond the ESO's control. In particular, panel members questioned whether the ESO should have had more appropriate contingencies in place to mitigate the risks associated with the unavailability of the WHVDC link. This included whether anticipatory arrangements for mitigation (eg intertrip agreements) had been appropriately considered and whether enough attention had been given to analysis on areas such as forecasting constraints and load flow capabilities.
- The panel suggested that the ESO should demonstrate that it has a clear strategy and framework for dealing with risks and putting in place contingencies. It should also be more transparent around its methodology for forecasting constraints and provide evidence on how robust these constraint forecasts are.
- The other key area noted by the panel was the ESO's balancing IT systems. The panel did not consider outcomes associated with the Electricity Balancing System (EBS) had been clearly delivered and noted stakeholder concerns around a lack of transparency and communication on the project. There was a belief that whilst the ESO was doing some good bespoke IT work in areas, it was taking too much of a piecemeal approach and not progressing the coordinated, large-scale IT upgrades that are required to operate the system efficiently. The panel asked for more evidence that clear substitutes to EBS are being delivered and that lessons from the EBS programme have been learnt.
- Views were divided on the vector shift work the ESO had undertaken this year. Some panel members were impressed with the ESO's identification of the problem and subsequent quick solution. However, other panel members felt that the problems associated with the Rate of Change of Frequency (RoCoF) and settings on embedded generators had been known to industry for many years and that changes could have been delivered earlier. They considered that the ESO should be dealing proactively with falling inertia as part of its baseline obligation to operate the system efficiently. They wanted to understand the ESO's future strategy on this and other system operability challenges.

Principle 3 - Ensure the rules and processes for procuring balancing services maximise competition where possible and are simple, fair and transparent

This principle requires the ESO to develop and procure additional ancillary or balancing services in a manner that maximises competition and is simple, fair and transparent.

Mid-year score	3
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Overall the panel agreed on a consensus score of 3.

- The panel noted that the ESO has taken positive first steps with the System Needs and Product Strategy (SNAPS) and associated product roadmaps under the future of balancing services workstream, but also noted stakeholders' feedback on the lack of progress, lack of transparency and delays. Some panel members questioned whether the ESO is under-delivering against the roadmaps and called for better communication on what would be delivered by when.
- The panel noted that the ESO provided some evidence of benefits (such as an increase in market entrants and cost reductions in the STOR and FFR market). They agreed that there are likely to be future benefits in this area as well, provided that the ESO can meet its deliverables. The panel encouraged the ESO to provide more evidence of tangible benefits going forward. For example, the panel agreed with stakeholder feedback which called for a specific performance metric measuring the percentage of contracts (by volume or value) that have been competitively procured and the panel would like the ESO to consider developing this (for instance in the response/reserve markets).
- One panel member considered that the ESO should be mindful of its market monitoring role and should be proactively assessing levels of competition in balancing markets.
- The panel felt that there had been some good initial steps on facilitating wider access to the BM, but that over the remainder of the year, this needed to be taken further. For example, by rolling solutions out to more parties and addressing all the practical steps needed to ensure a level playing field in practice (such as system changes and changing control room approaches).

Principle 4 - Promote competition in wholesale and capacity markets

This principle requires the ESO to drive forward competitive solutions and approaches wherever competition would drive efficiency and lead to consumer benefits, across all of its additional roles outside of direct balancing.

Mid-year score	2-3
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There were a range of views for this principle with scores between 2 and 3.

- Overall the panel noted that this principle had been relaunched in line with Ofgem’s feedback at the start of the year. As a result, the panel looked forward to seeing more progress and evidence of delivering benefits against the refreshed plan in the remainder of the year.
- The panel noted that the ESO has improved stakeholder satisfaction for its code administrator role (by 20% for the Grid Code and 10% for the CUSC). Whilst this is a sign of positive change, the panel noted that satisfaction with the ESO’s codes activities is still below the level that other code administrators achieve. The panel noted the ESO could do more to take on a strategic and leadership role, with some considering the ESO to be too reactive and risk-averse in this area. The panel noted that the ESO had increased resources in this area but still questioned whether the ESO’s code administrative function is adequately staffed or is given sufficient leadership priority.
- The panel members that awarded lower scores felt the ESO still had a lot more to do to show that it was meeting the expectations described under this principle. They felt that, to date, there was very limited evidence of the ESO taking advantage of its unique expertise and knowledge to show leadership in driving competition in market arrangements. They also highlighted issues with the management of, and support on, some existing code processes this year; such as P297 and CMP250.
- The panel noted some areas of positive performance, such as the ESO’s new fundamental review of BSUoS and the work done on the charging futures forum. The panel also look forward to the ESO demonstrating progress against its code improvement plan.

Principle 5 - Coordinate across system boundaries to deliver efficient network planning and development

This principle requires the ESO to collaborate, communicate and coordinate with other network operators to identify and support the delivery of the most efficient network planning and development solutions for the whole system.

Mid-year score	3
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After discussion, the panel agreed on a score of 3.

- Overall the panel considered that the ESO has taken steps in the right direction and has laid the groundwork for benefits in the future but noted that there needs to be more tangible evidence of progress and benefits delivered since 1 April.
- The panel viewed the Regional Development Plans (RDPs) as reflecting positive initiatives and noted some associated evidence of delivered benefits through the release of new capacity (under Metric 20). However, the panel felt that further evidence was required on whether progress in this area was beyond baseline expectations, noting Ofgem’s feedback in the formal opinion.
- The panel felt that the ESO could take more of a proactive leadership role in this area, such as facilitating consistent planning and modelling approaches across distribution networks. The panel also highlighted some of the feedback from network companies

regarding the need for the ESO to undertake earlier and broader engagement on whole system topics.

- One panel member initially put forward the case for a lower score, considering that the ESO should be marked down because of a lack of evidence of progress against the principle's expectations and the forward plan's aims. However, the majority of the panel felt that the ESO should be given credit for making progress with the initiatives reported, given that they had the potential for future benefits.
- Panel members also noted that the Principle 5 and Principle 6 relaunch and reorganisation of the report and associated deliverables had made it hard to fully follow progress. The panel encouraged the ESO to be clear and transparent about its original plans and how it is delivering against them in the end of year report.

Principle 6 - Coordinate effectively to ensure efficient whole system operation and optimal use of resources

This principle requires the ESO to take a whole system perspective in the operation of the network by coordinating with other network operators to develop processes that ensure optimal resource utilisation across the network.

Mid-year score	3
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After discussion, the panel agreed on a score of 3.

- The Panel noted the good stakeholder feedback on the ESO's engagement in Open Networks and Power Responsive and considered this a clear positive point in respect of this principle, and welcomed some of the improvements made in the area of connections.
- However, the panel wanted to see more tangible evidence of progress against the ESO's vision and clearer evidence of how the activities undertaken have delivered current, or will deliver future, benefits. Some members felt that the programme of work outlined could be more ambitious and that a number of the activities undertaken to date to improve coordination around connections were more in line with baseline expectations.
- Some panel members initially considered awarding a higher score, noting that a number of activities are likely to create future benefits. They thought that whilst the benefits were not obvious at this point, the ESO should receive credit for the fact that benefits are likely to materialise. Other panel members wanted to see the ESO consider and plan for a whole energy system that extends into consumers' homes/businesses, recognising that consumers' engagement will increase in the future.
- Some members welcomed the 'clear voice' and balance brought by the ESO to the Energy Networks Association (ENA) Open Networks project. Others, however, felt that the ESO could show more leadership in this area and do more to demonstrate a clear, joined-up organisational view of what the future system should look like to achieve effective whole system operation (eg through their RIIO-2 business planning).

Principle 7 - Facilitate timely, efficient and competitive network investments

This principle requires the ESO to identify long-term electricity system needs, develop and assess options to meet these needs and assess whether projects meet the criteria for competitive delivery.

Mid-year score	3
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Overall, the panel agreed on a score of 3.

- The panel felt there had been a good start to thinking on how the Network Options Assessment (NOA) process needs to evolve through the published roadmap; but that there was a lack of evidence on progress and benefits delivered so far this year (for example, the outputs of the pathfinding projects). Therefore, it was difficult to give the ESO a high score for delivered and future benefits based on the evidence provided. The panel noted that outcomes for activities under Principle 7 could be easier to judge at the end of the year.
- The panel noted mixed stakeholder feedback on this principle, with some market parties welcoming new efforts to engage on NOA, while other network operators felt that engagement did not go far enough. The panel also reflected on the ESO's own view that more could be done to raise awareness of the NOA process amongst non-traditional parties, and encouraged it to make progress on this by the end of the year.
- Some panel members thought that the majority of work to date was more in line with existing licence obligations around the NOA. One panel member had specific concerns about progress and felt that the ESO needed to make a bigger effort, as part of the activity associated with legal separation, to demonstrate to investors that it is independent and open to all options to address network issues.

Next steps

Our new framework relies on stakeholder input and engagement. We appreciate the engagement so far and encourage stakeholders to continue engaging with the process going forward.

We will continue monitoring the ESO's performance on a monthly basis.⁶ We encourage stakeholders to come forward with any feedback they would like to share on the ESO's performance to support our monitoring (this can be areas where you believe the ESO has met or exceeded baseline expectations and/or feedback on the areas where you may have concerns that baseline expectations are not being met). All feedback can be sent to ESOperformance@ofgem.gov.uk.

The ESO will be expected to publish the next quarterly (Q3) report which will provide evidence and a narrative for the ESO's performance for Q1-Q3 and update on its progress against its

⁶ Monthly reports are published on the ESO's website: <https://www.nationalgrideso.com/about-us/incentives/eso-incentive-performance-and-reporting>

forward plan. The ESO will engage separately with stakeholders on the contents of the next quarterly report.

We also recently published a call for input on the regulatory and incentives framework for 2019-20, asking for feedback on potential improvements we could make from April 2019. We are not proposing to make any fundamental changes to the new framework we introduced in April 2018, but are considering refinements based on lessons learned and experiences so far. This will take on board views put forward by the panel on their findings from the mid-year process, including the question of valuing future benefits. Whilst the call for input has now closed, if you would like to submit any feedback that we could consider going forward, please email ESOperformance@ofgem.gov.uk.