



Bringing Energy
Together

ADE Response to Ofgem Consultation on ESO RIIO-2 Funding Model and Incentive Scheme | 8 October 2019

Context

The ADE welcomes the opportunity to respond to Ofgem's **consultation on the ESO's funding model and incentive scheme under the RIIO-2 price control**. This response will focus on the regulatory and incentives section of the consultation, which is the section most relevant to ADE members.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

Response

Q15. Do you have any views on our initial thinking for how the ESO roles framework should evolve?

The ADE agrees with Ofgem's initial thinking on this question. The reduction to three ESO roles, with whole system outcomes as a cross-cutting behaviour, is likely to make evaluation of performance easier and reduce overlap between roles. Given the importance of the ESO facilitating whole system outcomes, however, it may be appropriate that evaluation of ESO performance against the three remaining role areas includes how far the changes help to facilitate these outcomes.

Q16. Do you support the introduction of a defined set of ESO outcomes and impacts? If so, what should these outcomes and impacts be?

The ADE supports the introduction of a defined set of ESO outcomes and impacts but believes that the outcomes should be more tangible than those suggested in the illustrative thinking in the consultation. An outcome should also be included to reflect the environmental benefits mentioned in the impacts. Given the ESO's commitment to enabling zero carbon system operation by 2025, a possible outcome could be 'lowest possible carbon system operation compatible with reliability and cost efficiency'.

Q17. Do you think any changes are needed to ESO's licence conditions in order to further clarify its baseline obligations?

Ofgem should consider introducing new license conditions around running the lowest possible carbon system and procuring balancing services through the most open, competitive route possible.

Q18. Do you agree the incentives scheme should be focussed on encouraging the ESO to provide an exceptional quality of service when delivering its price control funded activities? Do you agree with our initial views on what an exceptional quality of service would include?

The ADE agrees with this proposal and with Ofgem's initial views on what exceptional quality of service would include. Measures around an open data presumption and exceptionally transparent procurement, tendering and forecasting should also be included as part of this section. Another metric could focus on the ability for innovative, non-traditional market participants and business models to provide ESO services, without hard or soft barriers to participation.

Q19. Do you agree with our proposal to align the length of the incentive scheme with the two-year business planning cycle?

Yes. Aligning the incentive scheme with the two-year business planning cycle is the most logical approach, provided that the ESO's business plan is sufficiently strong, detailed and measurable.

Q20. Do you agree we should introduce the possibility of 'core' metrics for the ESO? And, do you have views on which areas of ESO performance we should consider for any core metrics?

The ADE believes that core metrics should only be introduced as a last resort, in the case where the ESO's metrics are not viewed as sufficiently clear, well-defined and stretching by Ofgem and stakeholders. In this case, the ADE agrees that it should be possible for Ofgem to define core metrics.

The ADE believes that all areas of ESO performance should be considered for core metrics. By definition, any area included in the business plan should be key to ESO performance. Metrics in relation to transparency of tendering, openness and competitiveness of procurement and levels of participation by non-traditional players are equally as important as those suggested by Ofgem in the consultation.

Q21. Should there be financial incentive implications for the ESO as a consequence of the business plan assessment process?

While it is essential that the ESO provide well-defined, stretching business plans, reducing the overall incentive pot could weaken the incentive scheme, thus reducing innovation on the part of the ESO. Such a measure would also introduce additional uncertainty around levels of incentives, making it harder for the ESO to design an ambitious and detailed business plan.

The ADE therefore believes that Ofgem should consider other mechanisms for motivating the ESO to produce the desired level of quality in their business plan. These mechanisms could include a smaller, standalone upside/downside incentive for the quality of the business plan, which did not affect the main incentive pot.

Q22. What if any changes might be needed to the incentives evaluation criteria?

It is essential that concrete performance metrics be given significant weight in the evaluation process. It is also important that the ESO be held to account for plan delivery to deadline, but that this be designed in a way that does not cause the ESO to be less ambitious. There may be value in including a consideration under plan delivery relating to the amount of notice provided to stakeholders of late delivery and what tangible efforts were taken to minimise the delay.

The ADE agrees that, given the use of cost-benefit analysis in the RIIO-2 business planning process, greater weight should be placed in criteria c)-e), compared to a) and b). If a) and b) are retained, the ADE agrees that it could be helpful to merge them into one single category.

Q23. How should we best include internal cost efficiency in the evaluation framework – should it be a performance metric or explicit criteria?

The ADE does not have a view on this question.

Q24. Should we continue to evaluate the ESO's performance by role? If so, do you agree that we should we tailor the evaluation approach to each role?

The ADE agrees that Ofgem should continue to evaluate the ESO's performance by role and that the approach should be tailored to each role. It is essential, however, that this does not result in the medium to longer-term roles lacking clear metrics, data and deadlines. While these roles may, by their nature, need to take a broader range of evidence into account, they should still involve robust, clearly defined metrics against an ambitious strategy, delivered to the agreed deadlines.

Q25. Do you think medium to longer term roles should have relatively more upside incentives focus than short term roles?

The ADE agrees that the medium to longer term roles should have relatively more upside but does not believe that they should be upside only. While some aspects of these roles, such as enabling zero carbon operation are more difficult to define up front, others, such as eliminating bilateral contracts and moving to close to real-time procurement in all possible markets, are easier to define and measure. Downside incentives play an important role in motivating the ESO to deliver on its commitments to time and should be retained in these areas.

Q26. Do these arrangements give stakeholders the right platform to shape ESO activity and hold it to account for its performance?

The ADE believes that the ESO performance panel gives stakeholders the right platform and should be maintained in broadly its current role and format. Ofgem should carefully assess whether including consideration of the ESO's input costs in the panel's duties would markedly increase administrative burden for the panel. If not, the ADE would support including this type of consideration in the panel's duties.

Q27. Do you have any further suggestions for improving the existing ESO performance panel arrangements?

The ADE does not have any further suggestions.

Q28. What if any changes should be prioritised and introduced early for the 2020/21 incentives framework?

The ADE does not have a view on this question.

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