



Ofgem
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Dear Sir or Madam

Thank you for the opportunity to respond to the RIIO-2 Methodology ESO for the Electricity System Operator consultation. Please find below E.ON's response.

Executive summary

Given the recent legal separation of National Grid ESO from NG Transmission, we believe it is vital to design an incentive scheme for ESO that is specific to the activities and roles it provides. These should incorporate current business as usual activities (such as reliability and cost reduction) but must also look wider to ensure that longer term goals (such as whole system thinking and decarbonisation) are given sufficient weighting. The incentive scheme must also work to tackle quantifiable benefits through key performance indicators but must also encourage longer term implementation of innovative thinking.

We are pleased that stakeholders are now able to be a fuller part of informing ESO performance and we believe that this has led to a greater degree of transparency and cooperation.

ESQ15. Do you have any views on our initial thinking for how the ESO roles framework should evolve?

We believe that the ESO roles framework is a sound methodology for evaluating ESO's performance. As a regulated business, ESO needs to be able to relate its activities to benefits it is providing to customers, including the drive towards Net Zero, but also the cost of balancing the system today. Using short- and long-term roles to link activities to customer benefits appears to be a sensible way forward. Therefore, for ESO to 'own' its priorities, it must be given clear high-level guidance across all its activities as to how these can impact customers (both individual and as a society). Therefore, we believe that the creation of four ESO impacts with related outcomes that can be mapped to ESO roles will help everyone understand what the ESO's activities should be trying to achieve.

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We also concur with Ofgem that whole system thinking should be an overarching role, impact and outcome and should be incorporated into the system operator's license condition (as per the changes to the DNOs and TOs license conditions). We believe that this should extend to the ESO being the sole system operator across all voltage networks in order to fully capture the benefits of balancing at all levels and avoiding competing priorities across system operators i.e. ESO balancing actions having an adverse effect on the distribution network. Other overarching principles should include simplicity (as per the flexibility principles recommended by Open Networks Project¹) and transparency (as recommended by the Energy Data Taskforce²)

However, we believe that the role framework, coupled with guidance from Ofgem and Government should help ESO prioritise between short term and long-term customer benefits.

ESQ16. Do you support the introduction of a defined set of ESO outcomes and impacts? If so, what should these outcomes and impacts be?

We believe that the ESO should have an incentive scheme based on quantifiable customer outcomes and impacts. These should explicitly cover short- and long-term targets such as cost efficiency, supporting net zero, reliability and safety with overarching outcomes/impacts of whole system coordination, transparency and simplicity.

ESQ17. Do you think any changes are needed to ESO's licence conditions in order to further clarify its baseline obligations?

Yes, to bring ESO in line with the whole system working license obligations for DNOs and TOs.

ESQ18. Do you agree the incentives scheme should be focused 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?

We agree that the incentive scheme should look to ensure the ESO delivers an exceptional quality of service for its price control funded activities including ambitious planning, timely delivery, transparent engagement, continual minimisation of system costs and perpetual challenging of internal costs. However, we also believe that the incentive scheme should explicitly cover the rolling out of successful innovation projects into business as usual and identification of whole system projects that can deliver financial/environmental benefits to society.

¹ <http://www.energynetworks.org/electricity/futures/open-networks-project/workstream-products/ws1a-flexibility-services.html>

² <https://es.catapult.org.uk/news/energy-data-taskforce-report/>

ESQ19. Do you agree with our proposal to align the length of the incentive scheme with the two-year business planning cycle?

Yes, we believe that by aligning the incentive scheme length with the business planning cycle ensures that the administrative burden on the ESO and Ofgem is kept to a minimum whilst retaining a regular opportunity for stakeholders to feedback on their experience of ESO. The one-year review of the incentive (influenced by stakeholder feedback) can then be used to set the level of incentive payment or penalty (which can then be later corrected by the full review).

ESQ20. 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?

There will always be key roles, impacts and outcomes that the ESO needs to deliver and these should form the basis of any key set of metrics. Outcomes such as those listed in 4.65 (BSUoS costs, BSUoS forecasting, internal costs, stakeholder satisfaction, reliability) are clearer vital for users, but longer term metrics linked to ESO's role in terms of net zero will also be essential to include in any key set of core metrics.

ESQ21. Should there be financial incentive implications for the ESO as a consequence of the business plan assessment process?

We believe that business plan incentives for the ESO should be aligned with those of the TOs and DNOs in order to ensure accurately costed business plans are presented, that they have sufficiently ambitious but realistic timescales and that stakeholder needs are incorporated into them.

ESQ22. What if any changes might be needed to the incentives evaluation criteria?

The current evaluation criteria for incentives appear to be suitable to the task in hand – ensuring that ESO are pushing themselves to achieve exceptional performance for the end user. Performance metrics should form the core of evaluation of business as usual activities whereas we believe it is sensible to consider a more qualitative approach for longer term projects that seek to improve performance. As stated in 4.83, for long term projects, plan delivery should be a key evaluation tool although this requires a level of expertise to understand whether the initial plan's timescales and budgets are ambitious enough. We also agree that the upside/downside asymmetry for incentives could be tailored to each criterion individually such as a more symmetric incentive for short term incentives such as BSUoS charges whilst assigning a more asymmetric incentive for longer term projects such as the design and delivery of a new suite of flexibility products.

In terms of a value for money evaluation criteria, we believe that this is better captured in the initial business plan incentive – that projects that deliver the most value for money should be prioritised. In terms of the ESO delivering value for

money overall, we believe that this is already captured in the customer benefits and stakeholder evidence evaluation criteria.

ESQ23. How should we best include internal cost efficiency in the evaluation framework – should it be a performance metric or explicit criteria?

The main issue for internal cost efficiency is being able to segment internal costs between roles i.e. how much of the finance department's costs are attributed to each role. Therefore, we believe a simple overarching internal cost efficiency performance metric of the whole of ESO should be included, but that individual internal cost efficiencies across roles adds a level of complexity that does not impact the customer in any way.

ESQ24. Should we continue to evaluate the ESO's performance by role? If so, do you agree that we should tailor the evaluation approach to each role?

We believe it is important to evaluate the ESO's performance by role as this allows inspection and challenge of the split between these roles i.e. is ESO focussed too heavily on short term business as usual activity at the expense of long-term strategic goals. As is described in ESQ22, we believe it is also sensible to tailor the evaluation approach to each role as each role has varying levels of quantifiable evidence that can be used to prove its performance. However, as covered in ESQ23, there are overarching performance metrics (such as internal costs) that maybe better tackled at a holistic, whole company level.

ESQ25. Do you think medium to longer term roles should have relatively more upside incentives focus than short term roles?

See response to ESQ22

ESQ26. Do these arrangements give stakeholders the right platform to shape ESO activity and hold it to account for its performance?

We have found our ability to have our voice heard by the ESO performance panel to be good and as such we believe the performance panel to be the right platform to shape and challenge the ESO.

ESQ27. Do you have any further suggestions for improving the existing ESO performance panel arrangements?

No

ESQ28. What if any changes should be prioritised and introduced early for the 2020/21 incentives framework?

We believe with the current uncertainty about the role of distribution system operators (DSOs) that explicit reference to whole system thinking and coordination ought to be prioritised. During the period in which the ESO license

conditions on this subject are brought into line with the DNOs we believe that the ESO ought to have whole system thinking incorporated directly into its incentive scheme. Thereafter, as stated in ESOQ15, whole system thinking can become an all encompassing aspect of all roles, outcomes and impacts.