

# Guidance

## The Electricity System Operator Reporting and Incentives Arrangements: Guidance Document **[DRAFT FOR CONSULTATION]**

**Publication date:** 7 January 2020

**Contact:** Maryam Khan

**Team:** ESO Regulation

**Tel:** 020 7901 7000

**Email:** ESOPerformance@ofgem.gov.uk

The ESO sits at the centre of our electricity system and has a number of different roles, from the day-to-day operation of the electricity network, through to managing new network connections and longer-term network planning. We regulate the ESO to help ensure its actions align with consumers' interests. The ESO Reporting and Incentive Arrangements aim to create transparency around the ESO's performance and make it clearly accountable to its stakeholders. They are designed to encourage the ESO make improvements to the way it performs its roles in order to maximise benefits for current and future consumers.

This Guidance Document for the ESO Reporting and Incentive Arrangements outlines the process and criteria for assessing the performance of the ESO; the reporting requirements placed on the ESO; and the methodology the Authority will use to determine an incentive payment or penalty each year.

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## Version History

Version	Changes	Purpose	Publication date	Release date
0.1	n/a	Consultation on the 'ESO Reporting and Incentive Arrangements Guidance Document – Draft Version'	23 February 2018	n/a
1	Clarifications to wording and minor issues addressed following review of consultation responses	To issue the ESO Reporting and Incentive Arrangements Guidance Document	28 March 2018	1 April 2018
2	Clarifications and changes to the evaluation process for regulatory year 2019-20, following consultation with industry	To update and revise the ESO Reporting and Incentive Arrangements Guidance Document for 2019-20	25 March 2019	1 April 2019
3 <b>[draft for consultation]</b>	Clarifications and changes to roles and evaluation criteria for regulatory year 2020-21, following consultation with industry. <b>Key changes have been highlighted in red.</b>	To update and revise the ESO Reporting and Incentive Arrangements Guidance Document for 2020-21	XX February 2020	1 April 2020

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## 1. Introduction

- 1.1. This chapter sets out the background to the ESO Reporting and Incentive Arrangements, the purpose of this Guidance Document and its status from a compliance perspective.

### Background to the ESO

- 1.2. The ESO sits at the centre of our energy system. It has a number of different roles, from the day-to-day operation of the electricity network, through to managing new network connections and longer-term network planning.
- 1.3. We regulate the ESO to ensure it acts in the interest of consumers. The regulatory framework for the ESO is currently made up of a number of different parts. This includes the obligations on the ESO in its licence, industry codes and primary legislation; the RIIO-T1 price control; and a number of additional reporting requirements and incentives.
- 1.4. We believe our rapidly evolving energy sector needs an ESO that proactively responds to longer-term system challenges and maximises consumer benefits across the full spectrum of its roles. We want the ESO to work more closely with its stakeholders and other energy sector parties to ensure there is a coordinated approach to system operation and planning. We also want a more dynamic ESO that readily responds to new developments.

### The ESO Reporting and Incentive Arrangements

- 1.5. In 2018 we introduced a new incentives and regulatory framework for the ESO. This included new reporting requirements for the ESO as well as an incentive framework that uses a broader, more evaluative approach. These arrangements - which were introduced under special condition 4M of the ESO's transmission licence - are together known as the ESO Reporting and Incentive (ESORI) Arrangements.
- 1.6. The ESORI Arrangements aim to create transparency around the ESO's activities and the way in which it performs these activities. They are designed to make the ESO more clearly accountable to its stakeholders across the full spectrum of its roles. Ultimately, they aim to encourage the ESO to seek improvements to the way it performs its roles in order to benefit both current and future consumers.

- 1.7. The ESORI Arrangements have been designed to complement existing regulatory arrangements for the ESO, including the RIIO-T1 price control (which expires at the end of March 2021). These arrangements will be in place until 31 March 2021. The lessons we learn from these arrangements will help inform the design of the ESO's RIIO-2 framework from April 2021 onwards.
- 1.8. This Guidance Document provides guidance around the processes and requirements involved in the ESORI Arrangements. In particular, it explains the processes and criteria used to assess the ESO's performance; the reporting requirements placed on the ESO; and the methodology the Authority will use to determine an incentive payment or penalty each year.
- 1.9. The ESORI Arrangements Guidance Document is issued by the Authority under Part D of special condition 4M (Electricity System Operator Reporting and Incentive Arrangements) of NGENSO's licence. As set out in special condition 4M.11, the Authority may make appropriate provision about or impose requirements in the ESORI Arrangements Guidance Document, which may include, but will not be limited to:
- the criteria against which the performance of the licensee will be assessed;
  - the process and procedures that will be in place for assessing the performance of the licensee, including the role of the ESO Performance Panel in this process;
  - the requirements the licensee must fulfil as part of the assessment process, including the information the licensee must provide and its attendance at ESO Performance Panel meetings;
  - the information used for the performance assessment, including how the Forward Plan, the Formal Opinion, the Mid-Year Report and the End of Year Report will be used in that evaluation;
  - how the assessment of the performance of the licensee will be used by the Authority to determine  $\text{IncPayExt}_t$  for the Relevant Year  $t$ ; and
  - any other matters relating to the regulation, governance, or administration of the ESORI Arrangements.

- 1.10. This document may be revised and reissued in accordance with Part D of Special Condition 4M.
- 1.11. Any subsequent material updates to this Guidance Document will be made following consultation with the impacted parties, including the ESO. As a key principle, any changes made within a scheme year, which materially change the way the ESO's performance is assessed would not apply until the next regulatory year (unless there is agreement that a change is necessary, for example, to correct an error or to improve a process).
- 1.12. For the avoidance of doubt, the contents of this Guidance Document do not impact the RIIIO-T1 price control or the incentives placed on the ESO as part of its Electricity Market Reform role, which will remain in place until March 2021. This document refers to the ESORI Arrangements only.

## **Compliance**

- 1.13. Where provisions of this Guidance Document require the compliance of the licensee, the licensee must comply with those provisions as if the Guidance Document were part of Special Condition 4M. However, we have also attempted to make this document accessible and informative to a range of stakeholders.
- 1.14. For the avoidance of doubt, this document is subordinate to the licence. This document does not change any definition or obligations contained within the licence and in the event of any ambiguity over the Guidance Document, the licence will take precedence.
- 1.15. The contents of this Guidance Document does not alter or supplement the ESO's compliance with its wider obligations under legislation, its licence or industry codes. References to 'baseline expectations' within this document are for the purposes of the ESORI Arrangements only.

## **Structure of this document**

- 1.16. The document is structured as follows:
- Chapter 2 provides an overview of the ESORI Arrangements. It provides guidance on the steps, processes and timings involved in the regulatory cycle.

- Chapter 3 explains the key considerations and criteria that the Performance Panel and Authority should follow in order to evaluate the performance of the ESO.
- Chapter 4 explains how the Authority should determine an incentive payment/penalty for the ESO for a particular year.
- Chapter 5 outlines the reporting requirements on the ESO, provides guidance on what these reports should contain and outlines some general standards of conduct for reporting.



## 2. The ESORI Arrangements process

This chapter provides an overview of the ESORI Arrangements. It provides guidance on the steps, processes and timings involved in the annual regulatory cycle.

### Overview of the ESORI Arrangements

- 2.1. Our regulatory approach for 2018-21 involves increased up front clarity around the behaviours we expect of the ESO; but it places the onus on the ESO to engage with stakeholders to identify how to best meet and exceed these expectations in order to maximise benefits for consumers.

#### The ESO roles and principles

- 2.2. Underpinning the ESO's regulatory framework is our Roles and Principles guidance. The Roles and Principles guidance describes the ESO's key activities and clarifies our expectations around how these activities should be performed. The Roles and Principles is a separate guidance document.<sup>1</sup> As detailed in this document, the content of the Roles and Principles guidance forms a key point of reference for the ESORI Arrangements.

#### The ESORI Arrangements

- 2.3. Under the ESORI 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 meet the expectations described in the ESO Roles and Principles guidance document. The plan should also explain how the ESO aims to maximise benefits for consumers in relation to each of the roles. The ESO will then report on its performance throughout the year and at the end of the year, when it will submit evidence on its performance.

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<sup>1</sup> ESO Roles and Principles guidance document:

[https://www.ofgem.gov.uk/system/files/docs/2019/03/eso\\_roles\\_and\\_principles\\_guidance\\_2019-20.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/03/eso_roles_and_principles_guidance_2019-20.pdf)

2.4. A Performance Panel will have a role in reviewing the ESO's plans, challenging its within-year performance and performing an end of year evaluation. The Performance Panel's performance evaluation will form a recommendation to the Authority, who will review evidence available in order to determine a financial penalty or reward for the ESO for the relevant regulatory year. Where the ESO can clearly demonstrate that the actions it has taken have gone beyond 'baseline expectations', then this should be reflected in an incentive reward. Equally, where the ESO has clearly failed to demonstrate that it has taken the necessary actions to meet baseline expectations, then this should result in an incentive penalty.

2.5. In summary, the ESORI Arrangements comprise:

- A requirement on the ESO to engage with stakeholders in order to produce a Forward Plan before the start of each regulatory year. This should set out the ESO's longer-term vision for unlocking additional consumer benefits as well as the specific steps it intends to take within the relevant regulatory year. Through this process, the ESO will also develop a set of Performance Metrics and Performance Benchmarks so stakeholders can track its performance.
- Requirements of the ESO to produce within year performance reports, including monthly reporting on the Performance Metrics, quarterly reports, a Mid-Year Report and an End of Year Report.
- A panel of independent experts and/or stakeholder representatives (the 'Performance Panel') who will be responsible for reviewing the ESO's Forward Plan and evaluating its performance based on clear ex-ante evaluation criteria.
- An 'evaluative' financial incentive, where the Authority will make a decision on a reward or penalty for the ESO at the end of the year. This will be informed by the recommendation from the Performance Panel and be based on an ex-ante payment/penalty methodology.

### **Regulatory year 2020-21**

2.6. We have reviewed the effectiveness of this scheme so far in light of practical experience and have made some amendments for 2020-21.<sup>2</sup> For the regulatory year 2020-21, we have streamlined the roles from four to three. This will take account of the synergies across the three roles. For the avoidance of doubt, no activities or expectations included against each of the previous roles have been removed. They have instead been re-categorised to the most appropriate of the three streamlined roles. This is set out in Figure 1 below. The financial incentive value of  $\pm\text{£}30\text{m}$  will remain the same and the three roles will be equally weighted at  $\pm\text{£}10\text{m}$  each. The principles will remain a key part of the framework and will continue to provide the ESO with clear guidance on the behaviours and standards we expect of it when performing its roles.

### **The ESO roles and principles**

2.7. The ESO's Roles and Principles guidance document sets out our high level view of the behaviours that the ESO should fulfil in order to co-ordinate and direct the flow of electricity onto and over electricity system in an efficient, economic and coordinated manner. The ESO's roles are the key guide for understanding our 'baseline expectations'. They explain our expectations of how the ESO should fulfil its licence obligations and are designed to help to align expectations between the ESO, the ESO's customers and stakeholders, Ofgem, and the Performance Panel. The ESO roles also help set the parameters for the ESO's Forward Plan and the evaluation process. The three roles and associated activities are shown in Figure 1.

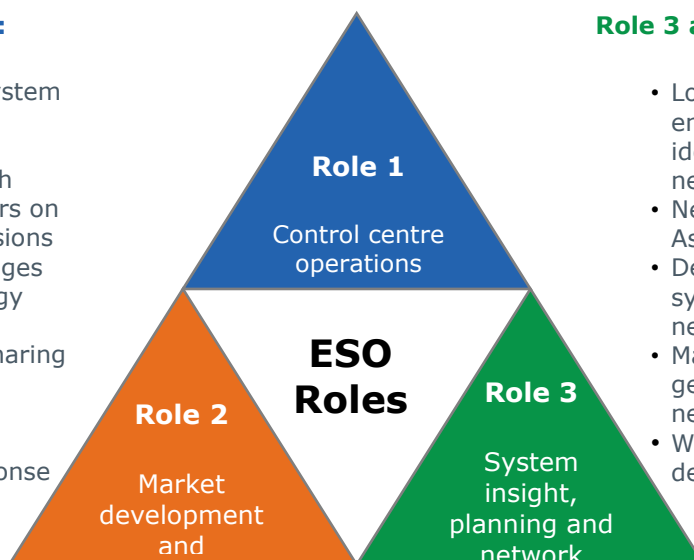
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<sup>2</sup> We consulted stakeholders on our thinking regarding the evolution of the roles and principles framework for the 2020-21 incentive scheme in our RIIO-2 consultation in August 2019: <https://www.ofgem.gov.uk/publications-and-updates/riio-2-financial-methodology-and-roles-framework-electricity-system-operator>

**Figure 1: Summary of the ESO roles and activities**

**Role 1 activities:**

- Operating the system (monitoring and dispatch)
- Coordinating with network operators on operational decisions and outage changes
- Short term energy forecasting
- Managing and sharing system data and information
- Restoration and emergency response



**Role 3 activities:**

- Long term forecasting, energy scenarios and identification of network needs
- Network Options Assessment
- Delivering competitive system solutions and early network competition
- Managing connections and generator access to the network
- Whole system process development

**Role 2 activities:**

- Balancing and ancillary service market design
- Service procurement and settlement
- Revenue collection
- Policy advice and delivery of market framework changes
- Code administrator

2.8. The ESO’s roles are designed to be overarching requirements or behavioural standards that can be applied flexibly to a rapidly changing electricity sector. The ESO’s licence conditions underpin the roles and remain the legal obligations that the ESO must fulfil.

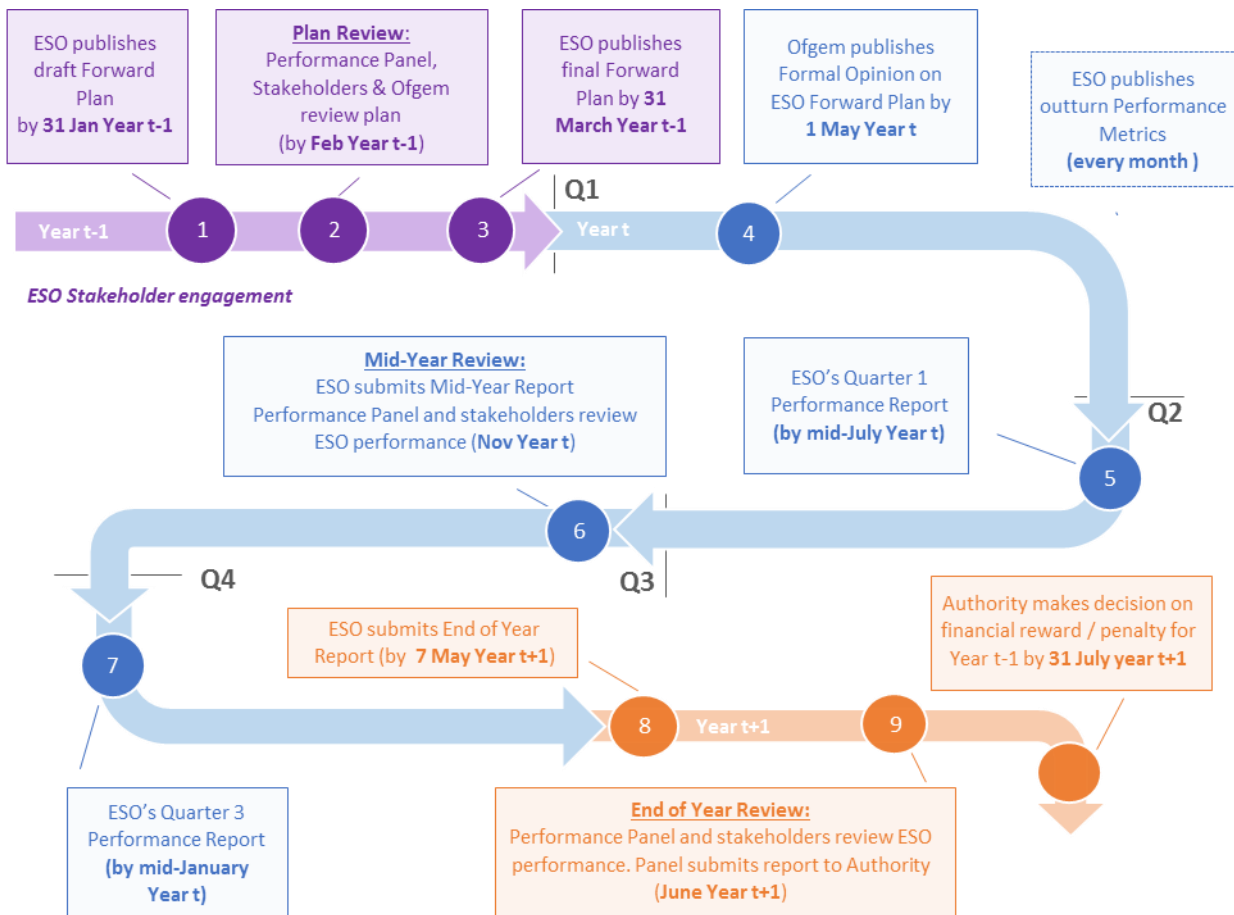
2.9. The ESO roles are outlined in more detail in our ESO roles and principles guidance document published on our website. This includes guidance on the behaviours or outputs we expect to see when the ESO fulfils its roles. The latest version of the ESO roles and principles guidance document will be published alongside this ESORI guidance document and will come into effect from 1 April 2020.

2.10. The ESO’s performance will be evaluated per role using the evaluation process described in Chapter 3.

**Stages in the annual ESORI Arrangements cycle**

2.11. Figure 2 provides an overview of the key stages in the reporting and incentives process for regulatory Year t. We provide guidance on each of these stages in the sections below.

**Figure 2: Regulatory process for Year t**



### Steps 1 to 4: The ESO Forward Plan

2.12. The ESO is required (under Special Condition 4M, Part C) to engage with its stakeholders to produce a Forward Plan before the start of each Regulatory Year t. This Forward Plan should set out, in relation to each of the Roles:

- The ESO’s vision for how it intends to drive consumer benefits through changes to way it carries out its system operator role (the ‘Longer Term Vision’);

- The specific steps the ESO intends to take in the year ahead to meet these aims (the 'Deliverables');
- A set of metrics for stakeholders to help track the ESO's performance during the regulatory year (the 'Performance Metrics'). Each Performance Metric should also be supported by 'Performance Benchmarks', that explain the level of performance that would be below, in line with and above baseline expectations.

2.13. Further guidance on the contents of the Forward Plan is in Chapter 5.

### **Step 1) The draft Forward Plan**

2.14. The ESO must engage with stakeholders to produce a draft version of the Forward Plan by 31 January in Year t-1 at the latest (this requirement is for Regulatory Years 2019/20 onwards). The draft Forward plan should contain all the details in paragraph 0 and in Chapter 5, including the full methodologies used to derive Performance Metrics.

2.15. The 31 January deadline is a last date for publishing the draft Forward Plan and starting a 'formal' consultation period on its contents. However, the ESO should ensure that it engages actively with stakeholders on the contents of its Forward Plan well before this deadline. The draft version of the Forward Plan should be based on the views and feedback provided to the ESO throughout the duration of the previous year. The draft Forward Plan must clearly demonstrate how these views have been taken into account. Where possible, we also encourage the ESO to publish the draft Forward Plan before the deadline.

### **Step 2) The Plan Review**

2.16. The formal Forward Plan consultation period should be at least four weeks long. The ESO should ensure it engages with a wide spectrum of stakeholders, including: potential new electricity industry parties; the Authority; and any other interested parties, including consumer representatives and academics.

2.17. The Forward Plan will be reviewed by the ESO Performance Panel. Ofgem will arrange a Performance Panel meeting **by** February. The Performance Panel will record its feedback on the Forward Plan in a report, which will be published on Ofgem's website in time for the ESO to take on board the Performance Panel's feedback.

### **Step 3) The final Forward Plan**

2.18. The ESO must publish a final version of its Forward Plan by 31 March in Year t-1. As required under special condition 4M.6, the final Forward Plan (including the Performance Metrics and Performance Benchmarks) should demonstrate how the ESO has incorporated the views of stakeholders, Ofgem and the Performance Panel. This should include an explanation of the reasons why points raised by stakeholders may not have not been factored into the final Forward Plan.

2.19. The Forward Plan should also clearly demonstrate how the ESO has actively sought and considered stakeholder views throughout the previous Relevant Year.

### **Step 4) The Authority's Formal Opinion**

2.20. We will aim to provide a 'Formal Opinion' on the final Forward Plan by 1 May each year. This will follow our review of the final Forward Plan, the stakeholder responses the ESO received and the Performance Panel's Forward Plan feedback report.

2.21. Before issuing the Formal Opinion, we will be able to seek further clarifications from the ESO around its Forward Plan (for example, if any unclear or ambiguous points remain). The ESO should respond to these questions and requests promptly and in line with the general guidance in Chapter 5.

2.22. In our Formal Opinion, we may comment on (subject to paragraph 2.25):

- The extent to which the ESO has articulated a clear long-term strategy and vision in relation to each Role.
- The 'ambition' of the Deliverables and Performance Metrics, by which we mean the level of coverage as well as the level of challenge within them. Specifically:
  - Whether the Deliverables and Performance Metrics are sufficient to measure performance across the three Roles, including whether they are reflective of the behaviours described under the supporting Principles.
  - The extent to which the associated Performance Benchmarks for below / in line with / above expectations in our view do fall below, meet or exceed baseline expectations.

- 2.23. Through our comments on each Role in the Formal Opinion, we may highlight examples of Performance Metrics and Deliverables that we believe are particularly ambitious or unambitious, to indicate to the ESO and Performance Panel the extent to which achieving those metrics should result in a higher or lower score.
- 2.24. The extent to which Ofgem would be able provide the feedback outlined in paragraphs 2.23 to 2.24 will heavily depend on:
- a) The ESO clearly evidencing how delivery of its final Forward Plan will meet/exceed baseline expectations and the extent of additional consumer benefits its actions will create.
  - b) The ESO extensively engaging with industry participants in order to validate the details of the specific Deliverables and Performance Metrics (including the Performance Benchmarks).
- 2.25. The Formal Opinion will be based on the information available to Ofgem at the time and is likely to be subject to a number of assumptions and caveats. For example, it may assume that the benefits identified by the ESO do materialise, and that nothing else changes throughout the year. In practice however, it is likely that situations will change throughout the year which the ESO would need to adapt to in order to continue to meet our baseline expectations. It is also likely that new opportunities may arise for the ESO to take actions to unlock consumer benefits that were not identified within the Forward Plan. Finally, it is important to recognise that the ESO's performance will not be evaluated solely on the delivery of its plan and/or Performance Metrics (see Chapter 3).
- 2.26. The Formal Opinion will be considered by the Performance Panel as part of its evaluation of the ESO's performance (as described in Chapter 4). The Authority will also consider the Formal Opinion when making its final determination on an incentive payment or penalty (as described in Chapter 5).
- 2.27. For the avoidance of doubt, the ESO's performance will be measured following the evaluation processes described in Chapters 4 and 5. The Formal Opinion does not restrict the ESO from achieving up to the maximum incentive cap or falling down to the maximum incentive floor.



- 2.28. It is vital that there is continuity between the different regulatory years. In compiling its Formal Opinion, Ofgem may also review previous years' reports and performance. Incentive baseline expectations should evolve each year and be tightened where there is outperformance (i.e. outperformance should be 'bankable' for consumers and not rewarded twice). Further guidance on how we may ensure continuity between different years is contained in Box 1.

### **Revisions to the Forward Plan**

- 2.29. The Forward Plan document published by 31 March will be final. However, we expect the ESO to remain flexible and adaptable throughout the year and respond to changing situations. The ESO should deviate from the plan where it identifies opportunities for greater consumer benefits. Equally, if an action in the plan turns out not to be in consumers' best interests then the ESO should change its approach and explain why. Situations may also arise during the year where the ESO may have to adapt its behaviour in order to continue to meet baseline expectations.
- 2.30. Whilst the Forward Plan document will not be revised once published, we expect any changing context and changes from the plan to be explained through the reporting throughout the rest of the year. Any additional changes to the Deliverables or Performance Metrics during the year should be added clearly via an addendum to the Forward Plan or within-year reports.

**Box 1: Guidance on scheme continuity / evaluating longer-term initiatives**

For the ESO to be judged as going above 'baseline expectations', it should be taking 'new' steps to deliver consumer value compared to previous years. This does not preclude the ESO from submitting evidence of new steps or innovations that go beyond expectations in pre-existing activities or projects. For example, the ESO may: identify a more efficient or more innovative way of approaching an existing activity that creates clear additional cost savings for consumers; develop a new solution to a system issue as a result of an overarching project or initiative; or successfully progress and deliver the next stage of a longer term initiative or innovation.

For many of the actions we expect the ESO to take to facilitate the energy system transformation, the benefits may not materialise for several years. The solutions to system challenges may also not be known immediately and industry parties may need to work together first to identify the best options. As set out in the evaluation criteria in chapter 3, the Performance Panel and Ofgem should recognise concrete steps to identify solutions to longer-term challenges and the clear progression of initiatives that could deliver future benefits for consumers. Where such steps clearly go beyond baseline expectations, they should strengthen the case for the ESO being seen to go above expectations (even if the full consumer benefits are expected to be delivered in future years). However, longer-term initiatives should not be rewarded when there is an evident lack of progress or limited tangible outputs. For example, when there have been no material developments in relation to a project or issue previously identified.

The ESO may have previously been awarded a higher performance score on the basis of the future delivery of an initiative. Ofgem and the Performance Panel should therefore look back at previous plans and performance reports to consider whether longer-term initiatives and previous commitments have been successfully delivered by the ESO. The ESO's failure to deliver previous commitments, particularly when it has been rewarded based on the delivery of these initiatives, would strengthen the case for it falling below baseline expectations.

## **Steps 5 to 7: Within year monitoring and reporting**

### **Step 5) Ongoing monitoring and reporting**

2.31. In order to create transparency around the ESO's performance throughout the year, and to help stakeholders, the Performance Panel and Ofgem monitor the ESO's progress against its Forward Plan, the ESO must publish on its website:

- Monthly updates of its performance against the Performance Metrics (by the 15th working day of the following month); and

- Quarterly reports which contain the ESO's narrative and reasons for its performance against its Performance Metrics, as well as an update on its progress against its Forward Plan. This should include a Q1 report, covering its performance during Q1, and a Q3 report, covering its performance during Q3.

2.32. See Chapter 5 for further guidance on these reports.

### **Step 6) The Mid-Year Review**

2.33. The ESO is required to produce and publish a report covering its performance during Q1 and Q2 (the 'Mid-Year Report') by the 15<sup>th</sup> working day in October in Year t. This will update stakeholders on the progress it has made against the Deliverables; its explanations for its outturn performance against the Performance Metrics; and the evidence of consumer benefits it has created. For the avoidance of doubt, the Mid-Year Report can be used to cover the contents of the quarterly report for Q2 (and can therefore supersede the Q2 report).

2.34. Following a review period of at least two weeks (depending on the views expressed and evidence presented), the ESO will then be required to attend a meeting to present the evidence contained in the Mid-Year Report to stakeholders and the Performance Panel. This meeting will be arranged in November in Year t, four weeks after the Mid-Year Report is published.

### **Step 7) The panel's Mid-Year Review Report**

2.35. Following this meeting, the Performance Panel will consider the evidence and record any conclusions made in a short summary report. This may highlight areas of good performance and any areas where concerns exist that should be tackled over the remaining months of the year. This report will be published on Ofgem's website two weeks after the Panel meeting. If the Performance Panel believes that sufficient evidence is available, the Performance Panel may choose to include provisional scores for each of the Roles in its report, in accordance with the evaluation criteria in Chapter 3.

## **Steps 8 to 10: Final Performance Evaluation**

### **Step 8) The End of Year Review**

- 2.36. By 7 May in Year t+1 at the latest, the ESO will be required to publish on its website, a report containing final evidence of its performance over the entire regulatory Year t (the 'End of Year Report').
- 2.37. There will then be a review period of four weeks for stakeholders, the Performance Panel and Ofgem to review the final evidence. During this time, the Performance Panel and Ofgem will be able to seek further clarifications from the ESO around its End of Year Report (for example, if there are any unclear or ambiguous points). The ESO should respond to these questions promptly and in line with the general guidance in Chapter 5.
- 2.38. Following this review period, the ESO will be required to attend a meeting to present the evidence contained in the End of Year Report to stakeholders and the Performance Panel. This meeting will be arranged by Ofgem for a date likely in the first week of June in Year t+1.
- 2.39. Before the meeting, we may produce a briefing report for the Performance Panel, highlighting any areas of concern or areas where we believe the ESO has performed above expectations.

### **Step 9) The panel's End of Year Review Report**

- 2.40. Following the Performance Panel meeting, the Performance Panel will reconvene to consider the evidence presented and score the ESO's performance against each Role, in line with the evaluation criteria in Chapter 3. The Performance Panel will explain the reasons for each score in a full report. This report will then be published on Ofgem's website by 30 June in Year t+1.
- 2.41. Following the publication of the Performance Panel's recommendations, stakeholders including the ESO, will have two weeks to submit any further representations regarding the Performance Panel's report to us, for the Authority to consider before reaching a final decision on the incentive payment or penalty.

### **Steps 10) Determination of a payment / penalty**

- 2.42. The Authority will consider the Performance Panel's recommendations, as well as any other evidence received or collected, and decide on an appropriate reward or penalty for the ESO. This will be calculated in accordance with the process described in Chapter

4. For the avoidance of doubt, the final decision will lie with the Authority who will form views based on the evidence available, including the Performance Panel's recommendation.

2.43. The Authority will produce its final decision on the incentive payment or penalty by 31 July in Year t+1, or such later date that it considers appropriate. This decision will be published on Ofgem's website.

### 3. ESO performance evaluation criteria

The purpose of this chapter is to set out guidance for how the Performance Panel should evaluate the ESO’s performance.

#### Background to the ESO

- 3.1. Following the submission of the ESO’s End or Year Report and the processes described in Chapter 2, the ESO Performance Panel will score the performance of the ESO in accordance with the guidance and criteria in this chapter.
- 3.2. For 2020-21, there will be three roles, as opposed to four previously – consisting of Role 1 (Control centre operations), Role 2 (Market development and transactions) and Role 3 (System insight, planning and network development). The Performance Panel will assess the ESO’s performance by carrying out the scorecard evaluation for each Role Area as described in this chapter. The principles will remain a key part of the framework and will continue to provide the ESO with clear guidance on the behaviours and standards we expect of it when performing its roles.

**Table 1: financial incentive parameters for 2020-21.**

<b>Role</b>	Role 1 – Control centre operations	Role 2 – Market development and transactions	Role 3 – System insight, planning and network development
<b>Role incentive range</b>	±£10m	±£10m	±£10m

- 3.3. For each of the roles, the Performance Panel should score the ESO on a scale of 1 to 5, where:

1 = Weak

2 = Poor

3 = Average (‘baseline expectations’)

4 = Good

5 = Excellent

## Understanding baseline expectations

- 3.4. The scoring approach works around an understanding of 'baseline expectations'. For the purposes of the ESORI Arrangements, baseline expectations means a level of performance expected from the ESO which would merit neither an incentive payment nor an incentive reward.
- 3.5. The Performance Panel should therefore develop an understanding of what constitutes baseline performance before its performance evaluation. Part of this understanding will come from the Authority's Formal Opinion, which will provide guidance on how stretching and ambitious the ESO's Deliverables, Performance Metrics and Performance Benchmarks are.
- 3.6. However, the Performance Panel may also need to make its own judgements in this area because:
- Circumstances may change throughout the scheme year that mean the definition of baseline changes. For example, a situation could arise which requires the ESO to adapt its behaviours in order to continue meeting baseline expectations.
  - Other or new evidence on the ESO's performance may be available that was not outlined or included as part of the ESO Forward Plan. For example, the ESO may identify a new opportunity for consumer benefits and/or a performance issue may exist which was not included in the Forward Plan.
  - The ESO may not have provided sufficient evidence in its Forward Plan, (or had sufficient validation of the plan by stakeholders), for the Formal Opinion to contain a clear steer on the plan's ambition.
- 3.7. Box 2 contains guidance on how to understand 'baseline expectations' for the purposes of the ESORI Arrangements.

### Box 2: Understanding 'baseline expectations'

A key principle for the ESO being able to achieve an above average score is that it has clearly evidenced the delivery of consumer benefits that go beyond 'baseline expectations'. This means there is clear and tangible evidence of the ESO taking new steps within that year to deliver better practices, business models and technologies that would not normally be expected by an efficient and competent system operator. These steps should lead to material improvements in the ESO's performance and unlock additional consumer benefits.

For the ESO to achieve a below average score, there should be insufficient evidence to demonstrate that the ESO is meeting baseline expectations. This means that the ESO has provided insufficient evidence to show that it is maintaining a level of service expected from an efficient and competent system operator. For example, there may be insufficient evidence that the ESO has taken clear actions to improve its performance in the areas where Ofgem, the Performance Panel and stakeholders have identified performance concerns.

It is important to note that in isolation, a new activity or improved performance in a particular area does not necessarily mean that the ESO has gone beyond baseline expectations. In some areas, the ESO may need to change or improve its performance in order to meet baseline expectations.

In practice, defining baseline expectations for each area of activity will likely require an element of judgement. This is particularly the case as, for many of the outcomes we expect from an organisation like the ESO, data driven targets are either very difficult to derive or are subject to wider factors that make them unreliable in isolation. The following information should help form an understanding of the baseline in each area:

- **The ESO Roles:** the ESO Roles and principles guidance document is the key guide for understanding baseline expectations. It explains our expectations of how the ESO should fulfil its roles and is designed to help align expectations between the ESO, Ofgem and stakeholders, and the Performance Panel. The ESO roles should be considered as overarching requirements or behavioural standards that can be applied flexibly to a rapidly changing energy sector.
- **The ESO's Forward Plan and performance metrics:** The ESO's Forward Plan and performance metrics should support the roles by explaining what the ESO intends to do in practice that year to meet and go above and beyond expectations and/or address areas of underperformance.



- **Ofgem’s Formal Opinion:** assuming the ESO has met the requirements described in Chapter 2, the Formal Opinion should help the Performance Panel to understand our view of the extent to which the Deliverables and Performance Metrics for each role either meet, exceed or fall below Ofgem and stakeholders’ expectations.

Where situations change or new evidence is available the Performance Panel may need to consider how the evidence presented compares to baseline expectations. It should make a judgement based on the roles and evidence presented by the ESO, Ofgem and stakeholders.

## Performance evaluation criteria

3.8. The Performance Panel will use four key inputs to evaluate the ESO’s performance. In determining a score for each role, the key criteria the Performance Panel should take into account are:

- a) Evidence of consumer benefits
- b) Stakeholder views
- c) Plan delivery
- d) Outturn performance metrics and justifications

3.9. These criteria are designed to be considered together to establish an overall picture of the ESO’s performance for each role. Below we describe examples for each criterion that may contribute to the Performance Panel awarding a higher or lower score.

### a) Evidence of consumer benefits

3.10. For the incentive period 2020-21, when assessing this criterion the Performance Panel should take into account evidence of delivered benefits as well as any evidence of future benefits / longer term initiatives. For some activities, the ESO may only be able to provide evidence of either delivered benefits or future benefits. When assessing either evidence of delivered benefits or evidence of future benefits, we have detailed below the guidance the panel should refer to.

### Evidence of delivered benefits

3.11. The Performance Panel should take into account the extent to which the ESO has demonstrated and evidenced the achievement of *additional* consumer benefits within the relevant performance year. As part of this, the panel should consider:

- the overall strength of the evidence (in line with the guidance described Box 3);
- the estimated size of the delivered benefits;
- any supporting or counter evidence provided by stakeholders or Ofgem (including Ofgem’s Performance Panel briefings).

3.12. The Performance Panel should consider that the ESO has outperformed this criteria if it is confident that the ESO has demonstrated the delivery of benefits for consumers which go beyond baseline expectations (these benefits can be demonstrated qualitatively and/or quantitatively). The Performance Panel should also be confident that any additional evidence presented to it by stakeholders or Ofgem supports the ESO’s conclusions. For example, it should be clear that the ESO has sought to maximise benefits; this would mean that the consumer benefits have not come at the expense of other initiatives with industry parties, including other ways of delivering the same initiative, that would deliver a better outcome overall for consumers.

3.13. The Performance Panel should consider that the ESO has underperformed this criteria if the ESO has not sufficiently demonstrated that it has delivered up to baseline expectations. This would include the ESO being unable to provide sufficient evidence that it has taken steps to address areas where performance concerns have been previously raised, including through the Forward Plan process. It would also include the ESO being unable to sufficiently explain actions (or inaction) which may have led to consumer detriment.

### Evidence of future benefits / progress against longer-term initiatives

3.14. The Performance Panel should consider the extent to which the ESO has provided evidence of actions and activities that may lead to longer-term consumer benefits. It is vital for the overall efficiency of the system that the ESO takes a longer-term view and works with its stakeholders to identify solutions to system challenges. We expect the ESO to consider and address the energy system’s longer-term needs as part of its

baseline behaviours. However, the ESO should be recognised for steps in relation to longer-term initiatives that clearly go beyond baseline expectations. The Performance Panel may consider the guidance in Box 1 on ensuring scheme continuity / evaluating longer-term initiatives, as part of its assessment in this area.

- 3.15. The Performance Panel should consider the ESO has outperformed this criteria if there is strong evidence of the ESO going beyond baseline expectations when thinking about the system's longer term needs. This should include evidence of significant efforts to collaborate and cooperate with other stakeholders in order to develop solutions that maximise consumer benefits. Strong evidence in this area would include quantification of the future costs and benefits associated with longer-term initiatives. Where this is not possible, a robust qualitative description of benefits will be also considered. However, the Performance Panel should also recognise cases, for example, where the ESO may need to first work with industry to identify the best solutions to problems. In these cases, the Performance Panel should recognise and reward the ESO for developing robust processes, which have clear longer-term aims and clear future milestones and outputs.
- 3.16. The Performance Panel should consider the ESO has underperformed this criteria if the ESO does not provide sufficient evidence that it is considering the energy system's longer term needs. This would also involve evidence that the ESO has not effectively engaged with other industry parties or supported other initiatives to ensure that the best solutions are developed. The Performance Panel should also consider a below average score if there is evidence that initiatives committed to in previous years have not made sufficient progress or delivered tangible outputs.

## **b) Stakeholder views**

- 3.17. The Performance Panel should consider stakeholder views on the ESO's over/under performance for each role. This may include views provided by stakeholders during the Mid-Year Review and End of Year Review process, or any of the ESO's consultations or surveys throughout the year. Ofgem may also provide the Performance Panel with any stakeholder views it has collected throughout the year. For example, through ongoing monitoring or consultations.

- 3.18. The Performance Panel should consider the ESO has *outperformed this criteria* if there is a broad consensus<sup>3</sup> amongst stakeholders that the ESO has performed above expectations for that role. The panel should consider whether the ESO has provided sufficient justification and explanation of any negative stakeholder feedback they have received. In addition, there is evidence that the ESO has actively sought and taken into account the feedback of stakeholders throughout the year.
- 3.19. The Performance Panel should consider the ESO has *underperformed this criteria* if there is a broad consensus amongst stakeholders that the ESO has performed below expectations for that role, and the ESO cannot provide satisfactory reasons for why this is the case when challenged. In addition, there is evidence that the ESO has not actively sought and taken into account the feedback of stakeholders throughout the year.

### **c) Plan delivery**

- 3.20. The Performance Panel should consider whether the aims and Deliverables contained in the ESO Forward Plan have been successfully delivered on time and to a satisfactory standard. The Performance Panel should also take account of Ofgem’s Formal Opinion which may identify the extent to which the Deliverables identified for a role constitute below / in line with / above baseline expectations.
- 3.21. The Performance Panel should consider that the ESO has *outperformed this criteria* if the ESO has either gone above and beyond the Deliverables identified in the Forward Plan and/or it has successfully delivered a set of Deliverables which were identified in Ofgem’s Formal Opinion as being ambitious / beyond baseline expectations.
- 3.22. The Performance Panel should consider that the ESO has *underperformed this criteria* if the ESO has failed to successfully deliver Deliverables in the Forward Plan to baseline expectations.

### **d) Outturn performance metrics and justifications**

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<sup>3</sup> ‘Broad consensus’ does not mean there needs to be complete unanimity and agreement amongst stakeholders about the ESO’s performance. The panel should consider carefully whether the stakeholder feedback could be influenced by the particular interests of the party providing the feedback.

- 3.23. The Performance Panel should consider the ESO's outturn performance against its Performance Metrics and the ESO's justifications for this outturn performance. The metrics taken alone should not be considered as sufficient evidence to justify performance. Instead, they should be considered with the supporting explanations provided by the ESO of the actions it has taken to achieve consumer benefits. The Performance Panel should also consider any wider factors outside of the ESO's control that could have impacted the Performance Metric (such as weather, market trends etc). In addition, the Performance Panel should consider Ofgem's Formal Opinion on the different Performance Metrics, as this may indicate how stretching the metrics for each role are.
- 3.24. The Performance Panel should also consider whether significant over/under performance for a particular Performance Metric should result in that metric having a greater relative influence on the overall score for each role. For example, significant underperformance of a metric which is deemed to have a large impact on consumer costs, should be viewed by the Performance Panel as relatively more important than slight outperformance of several other metrics that are deemed to have less consumer value.
- 3.25. The Performance Panel should consider the ESO has *outperformed this criteria* if the ESO has outperformed the majority of its performance metrics and there are clear reasons for why this is the case. Alternatively, the ESO may have significantly outperformed a particular metric that is particularly stretching or has high associated consumer value.
- 3.26. The Performance Panel should consider the ESO has *underperformed this criteria* if the ESO has underperformed the majority of metrics, and there are no strong reasons or mitigating circumstances for this. Alternatively the ESO may have significantly underperformed a particular metric that has high associated consumer costs.

**Box 3: Strength of the evidence submitted**

Under the ESORI Arrangements, the onus is on the ESO to provide evidence of its performance. In order for the ESO to achieve an above average score, there needs to be clear and unambiguous evidence that it has gone beyond baseline expectations. This should include clear and tangible examples of actions which have led to additional benefits for the industry and consumers.

Strong evidence would include a clear quantification and/or articulation of the impacts associated with the actions the ESO has taken. Where there are material interventions or changes to arrangements, strong evidence should also include a clear demonstration that the ESO has, where appropriate, assessed multiple solutions to issues and chosen the ones that maximise consumer value. In addition, it should be clear that the ESO has not solely pursued an ESO-led solution without considering whether pursuing or supporting other industry initiatives could have resulted in greater consumer value. Strong evidence should also include clear explanations and justifications around the ESO's outturn Performance Metrics. Achieving or beating a target in isolation is insufficient to explain performance. Instead, Performance Metrics need to be accompanied with descriptions and evidence of what the ESO has done to achieve those outcomes.

Weak evidence would include overly vague or intangible descriptions of actions to deliver additional benefits or to address previous performance issues. Weak evidence would also mean the ESO being unable to justify its outturn performance metrics with clear examples of the actions it has taken to deliver those outcomes. Further examples of strong and inadequate evidence are shown in the table below.

The Performance Panel should only take evidence of consumer benefits into account where the ESO can demonstrate consumer value driven by 'new' actions or through undertaking existing activities or projects in new, more efficient or innovative ways. For example, the ESO may identify a new and innovative way of approaching an existing activity that creates clear cost savings for consumers or develop a new solution to a system issue, as a result of an overarching project or initiative (as described further in Box 1).

ESO initiatives which are funded under RIIO-T1 innovation schemes should also be discounted, unless it is clear that the ESO has gone above and beyond simply delivering the initiative in order to achieve additional consumer value (taking into account the funding amount).

**Illustrative examples of strong and inadequate evidence**

<b>Examples of strong evidence</b>	<b>Examples of inadequate evidence</b>
<ul style="list-style-type: none"> <li>• Tangible examples of steps the ESO has taken to deliver consumer benefits</li> <li>• Clear articulation and/or reliable, accurate quantification of the overall impact on consumers of its actions (strong quantitative and/or qualitative evidence is provided)</li> <li>• Performance metrics come with clear and unambiguous examples of the ESO’s actions and explanations of the wider context</li> <li>• Clear consideration of different solutions and consultation with different parties</li> </ul>	<ul style="list-style-type: none"> <li>• Vague and ambiguous descriptions of ESO activities</li> <li>• Limited articulation or quantification of consumer benefits (limited quantitative or qualitative evidence is provided)</li> <li>• Limited explanation of outturn performance metrics, with no concrete examples of the ESO’s actions or consideration of wider factors</li> <li>• Limited consideration of alternative solutions or consultation with other industry parties</li> </ul>

**Overall scoring for each role**

3.27. The Performance Panel should assess the overall evidence provided for each role. This includes considering whether the ESO has demonstrated performance in line with the expectations in the ESO’s Roles and Principles guidance for each of the roles. There is no explicit weighting associated with the evaluation criteria listed in 0 for each Role. Instead, they are the key pieces of information the panel should consider when forming an overall judgement on ESO performance for each role. The Panel should consider which criteria is most relevant to each role and therefore make a judgement on the relative weight of the criteria for each role, recognising that there will be a degree of overlap between the criteria in practice.

3.28. The Performance Panel should award a **score of 3** if it believes, considering all the evidence available, that the ESO has met baseline expectations, but there is insufficient evidence to suggest it has gone beyond that level. The Performance Panel should also award a score of 3 if it feels there are competing positive and negative factors which ultimately balance each other out.

- 3.29. The Performance Panel should award a **score of 4 or above** if it is confident that, considering all the evidence available, that the ESO has gone beyond baseline expectations to deliver additional consumer benefits. A **score of 5** should be awarded if there is clear and unambiguous evidence that the ESO has delivered significant additional consumer benefits. This could include a situation where the ESO has clearly outperformed all four of the performance evaluation criteria.
- 3.30. The Performance Panel should award a **score of 2 or below** if it does not consider that, considering all the evidence available, the ESO has been able to demonstrate that it has met baseline standards for that role. A **score of 1** should be awarded in the situation where there the Performance Panel has significant concerns about the ESO's demonstration of baseline performance for that role. This could include a situation where the ESO has clearly underperformed all four of the performance evaluation criteria, and there is unconvincing evidence to justify this underperformance.
- 3.31. In recommending a score, the Performance Panel should be mindful that these scores form the basis of a recommendation to the Authority on the level of incentive/payment penalty or reward. The Performance Panel should only award a score for a role, if it is confident that any consumer benefits created by the ESO (factoring in potential future benefits) significantly outweigh the incentive payment (see chapter 4 for more information).
- 3.32. The table below provides an illustrative guide of the evidence we expect should be associated with each score category for each of the criteria listed in 0. As described in 3.27, the criteria is not equally weighted. The Panel should make a judgement on the relative weight of the criteria for each role, and note that there may be a degree of overlap between certain criteria in practice.
- 3.33. The Performance Panel should record and explain its reasons for the scores it assigns for the ESO against each role and record its rationale in a full report, as set out in Chapter 2.



	Underperformance		Baseline	Outperformance	
	Weak (1)	Poor (2)	Average (3)	Good (4)	Excellent (5)
<b>a) Evidence of consumer benefits</b>	<ul style="list-style-type: none"> <li>× Very weak / no demonstration of delivered consumer benefits (qualitative and/or quantitative)</li> </ul> <p>And / or</p> <ul style="list-style-type: none"> <li>× No evidence of tangible long term initiatives with future benefits</li> <li>× No progress with previous longer term commitments</li> </ul>	<ul style="list-style-type: none"> <li>× Weak demonstration of delivered consumer benefits (qualitative and/or quantitative)</li> </ul> <p>And / or</p> <ul style="list-style-type: none"> <li>× Little evidence of tangible long-term initiatives with future benefits</li> <li>× Lack of progress with previous longer term commitments</li> </ul>	<ul style="list-style-type: none"> <li>✓ Adequate demonstration of delivered consumer benefits (qualitative and/or quantitative)</li> </ul> <p>And / or</p> <ul style="list-style-type: none"> <li>✓ Adequate evidence of tangible long-term initiatives with future benefits</li> </ul>	<ul style="list-style-type: none"> <li>✓ Strong demonstration of delivered consumer benefits (qualitative and/or quantitative)</li> </ul> <p>And / or</p> <ul style="list-style-type: none"> <li>✓ Good evidence of tangible long-term initiatives with future benefits</li> <li>✓ Good collaboration with other industry parties</li> </ul>	<ul style="list-style-type: none"> <li>✓ Very strong demonstration of significant delivered consumer benefits (qualitative and/or quantitative)</li> </ul> <p>And / or</p> <ul style="list-style-type: none"> <li>✓ Significant evidence of tangible long-term initiatives with future benefits</li> <li>✓ Significant collaboration with other industry parties</li> </ul>
<b>b) Stakeholder evidence</b>	<ul style="list-style-type: none"> <li>× <b>Significant</b> Negative stakeholder feedback and wider evidence on ESO performance, <b>without any strong justifications</b></li> </ul>	<ul style="list-style-type: none"> <li>× Mostly Negative stakeholder feedback on ESO performance, <b>without any strong justifications</b></li> </ul>	<ul style="list-style-type: none"> <li>✓ Mixed stakeholder views on ESO performance, <b>with some justification of poor performance</b></li> </ul>	<ul style="list-style-type: none"> <li>✓ Mostly positive stakeholder feedback on ESO performance, <b>with strong justifications of any negative feedback</b></li> </ul>	<ul style="list-style-type: none"> <li>✓ <b>Significant</b> Positive stakeholder feedback on ESO performance, <b>with strong justifications of any negative feedback</b></li> </ul>
<b>c) Plan delivery</b>	<ul style="list-style-type: none"> <li>× Unsuccessful delivery of BAU deliverables</li> </ul>	<ul style="list-style-type: none"> <li>× Partly successful delivery of baseline deliverables</li> </ul>	<ul style="list-style-type: none"> <li>✓ Successful and satisfactory delivery of all baseline deliverables</li> </ul>	<ul style="list-style-type: none"> <li>✓ Successful delivery of an ambitious set of deliverables</li> </ul>	<ul style="list-style-type: none"> <li>✓ Successful delivery of a very ambitious set of deliverables</li> </ul>
<b>d) Outturn Performance Metrics and justifications</b>	<ul style="list-style-type: none"> <li>× Below expectations for all Performance Metrics, without any strong justifications</li> </ul>	<ul style="list-style-type: none"> <li>× Below expectations for most Performance Metrics, without any strong justifications</li> </ul>	<ul style="list-style-type: none"> <li>✓ Most Performance Metrics in line with expectations</li> <li>✓ Outperformed most metrics, but no strong justifications</li> </ul>	<ul style="list-style-type: none"> <li>✓ Above expectations for most Performance Metrics, with strong justifications</li> </ul>	<ul style="list-style-type: none"> <li>✓ Above expectations for all Performance Metrics, with strong justifications</li> </ul>

## 4. Methodology for determining an incentive payment / penalty

This chapter describes how the Authority will determine an incentive payment / penalty for the ESO for a particular year.

### Determination of an incentive payment or penalty

#### Total incentive value

- 4.1. The maximum reward/penalty the ESO can achieve for 2020-21 is  $\pm$ £30m. As a default, this will be split equally among each of the three roles ( $\pm$ £10m per role).
- 4.2. We expect there to be a three-step process for determining the overall reward or penalty:
  - Step 1: Authority review of scoring
  - Step 2: Calculation of a default reward/penalty and incentive range
  - Step 3: The adjustment process

#### Step 1) Authority review of scoring

- 4.3. The Authority may review the recommendation made by the Performance Panel, alongside any other evidence submitted. It may make a judgement on whether it believes these scores are correct or whether they should be changed. This should use the same criteria described in Chapter 3.
- 4.4. This scoring review may also include a review of the feedback initially provided to the ESO as part of Ofgem's Formal Opinion. If there is a significant deviation between the up-front feedback and the Performance Panels' report, then the Authority may consider whether this is justified by the ESO's outturn performance, evidence collected throughout the year and any changing situations or context.

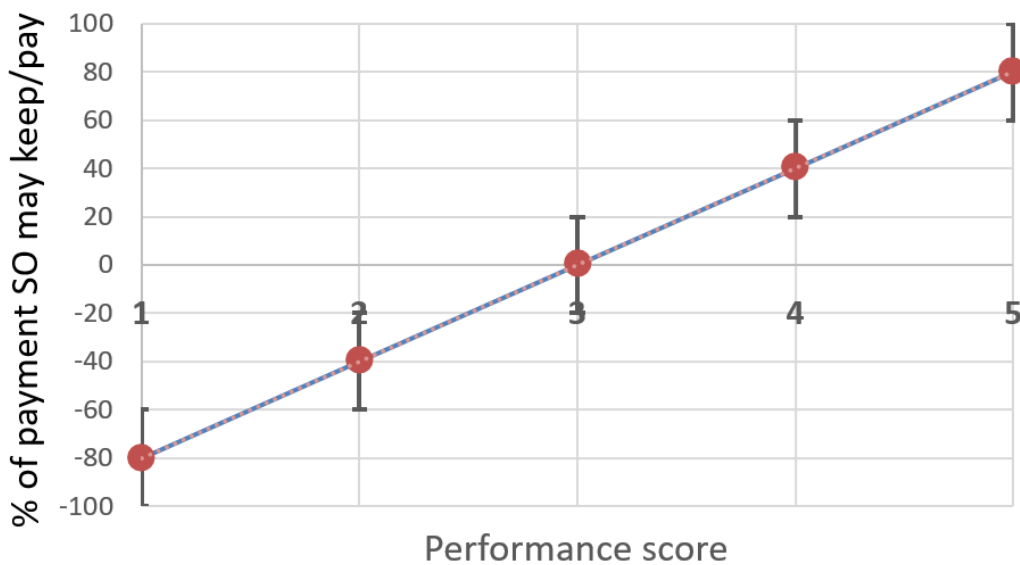
4.5. The Authority may also consider any additional evidence submitted by stakeholders or the ESO which presents a clear and evidenced case for the Authority to consider amending the Performance Panel’s recommendation.

4.6. The Authority will then determine a final score for each role.

**Step 2) Determining a base reward or penalty**

4.7. The final scores will determine a default position on the level of incentive payment or penalty, as well as an incentive range. **Each score corresponds to a default incentive payment or penalty and has an associated financial range.** These default positions will be calculated in accordance with the linear score:reward relationship shown in Figure 3.

**Figure 3: score:reward relationship**



4.8. For 2020-21, these default payment/penalty and incentive range for each score will be:

Score	1	2	3	4	5
Default % of payment ESO may keep/pay	-80	-40	0	40	80
Default incentive payment (£m)	-8	-4	0	4	8
% of payment ESO may keep/pay (incentive range)	-60 to -100	-20 to -60	-20 to +20	+20 to +60	+60 to +100
Incentive Range (£m)	-10 to -6	-6 to -2	-2 to 2	2 to 6	6 to 10

4.9. For example, the following scores would result in the following default incentive payment/penalty and overall range:

Principle	Role 1	Role 2	Role 3
Score	4	3	2
Default payment (£m)	4	0	-4
Range (£m)	2 to 6	-2 to 2	-6 to -2
Total default payment (min to max range)	<b>£0m</b> (-£6m to £6m)		

### Step 3) Adjustment process

4.10. The Authority may consider whether the incentive payment should be adjusted from this default within each score bracket. The Authority may consider adjusting the default incentive payment/penalty in the following circumstances:

- Evaluation of consumer costs / benefits:** the Authority may consider whether the base incentive payment/penalty is justified by the evidence of costs/benefits created for consumers (including a consideration of potential future benefits and rewards for commitments in previous years). As a principle, the ESO should only receive an incentive reward if this is clearly outweighed by the benefits created for consumers. Equally, an incentive penalty should be proportionate to the costs

created for consumers. The Authority may consider the evidence presented and judge whether the additional benefits/costs are justified by the incentive payment/penalty. If the Authority does not feel that this is the case then it may adjust the payment up or down.

- **Close scoring decisions:** if there is a particularly close call between two scores (for example, performance is borderline between score 3 and score 4), then the Authority may decide to adjust the payment up or down to reflect this.
- **Comparison to Formal Opinion:** the Authority may review the feedback initially provided to the ESO as part of Ofgem’s Formal Opinion. We will also take into consideration whether the deliverables or performance metrics were revised in relation to our feedback.

4.11. Any adjustments made would remain within the incentive ranges determined for each Role in Step 2. Any adjustments to the reward / penalty from the default amount will be in no less than 10% increments within the incentive range. For example the ESO may get a score of 4 for role 1. Therefore the default amount associated with a score of 4 is £4m (or 40% of the incentive pot for role 1). If upon assessing the evidence, we consider that the ESO has demonstrated enough evidence to warrant a higher incentive reward, then they will be moved up by 10% increments, and could receive either 50% or 60% of the total incentive payment.

4.12. In practice, there may be crossover between Role (for example, the ESO may develop an innovative whole-system solution that increases balancing cost efficiency; or, for example, poor outage coordination could increase within year balancing costs). In these circumstances, the Authority may consider whether adjustments should be made to multiple relevant Roles.

## 5. ESO reporting requirements

This chapter outlines the reporting requirements on the ESO as part of the ESORI Arrangements and provides guidance on what these reports should contain.

### Guidance around specific requirements

- 5.1. As outlined in Chapter 2, there are a number of reporting requirements on the ESO as part of the ESORI Arrangements. This includes:
- The ESO's Forward Plan (before start of year)
  - Outturn performance metrics (each month)
  - Quarterly reports (for Q1 and Q3)
  - Mid-year Report (covering performance in Q1-Q2)
  - End of Year Report (covering performance across whole year)
- 5.2. These reporting documents should be consistent in their structure in order for there to be comparison and read across from the Forward Plan to the Monthly, Quarterly, Mid-year and End of Year Reports. This is to ensure that stakeholders and the Performance Panel can clearly review and assess the ESO's performance throughout the year. The ESO should engage with its customers and stakeholders and take into account any feedback on the content or structure of the reports. The ESO can structure these documents per Role in order to align with the evaluation process. In order to demonstrate compliance with special licence condition 4M.3, the ESO must ensure it considers the supporting guidance outlined in the Roles and Principles guidance document when structuring its reports for each Role.
- 5.3. The reporting requirements in 5.1 should clearly document the Deliverables and Performance Metrics for each Role and provide an update on them. Any changes to the Deliverables throughout the year from the Forward Plan should be clearly identified and outlined in the reporting documents (eg in a separate sub-section).

- 5.4. Further guidance on these reports is provided below. The ESO is required to publish all of these reports on its website. Where there is any confidential or commercially sensitive information, then this should be redacted.
- 5.5. As set out in special licence conditions 4M.17 and 4M.18, the ESO must ensure to the best of its knowledge that the information provided in respect of the reports in this section are accurate and correct. Where the ESO identifies that the information provided is not accurate or correct, the ESO must notify the Authority and publish or resubmit corrected information as soon practicably possible, unless otherwise agreed with the Authority.

### **ESO Forward Plan**

- 5.6. The Forward Plan should cover the ESO's Long Term Vision, the Deliverables and the Performance Metrics.
- 5.7. The ESO should present its Forward Plan using the roles specified in the ESO Roles and Principles guidance document 2020-21.

#### *The Long Term Vision*

- 5.8. This should outline the ESO's longer-term aims for driving additional consumer benefits for each of the three Roles. The Long Term Vision for each role should have sufficient coverage of the supporting guidance in the ESO roles and principles guidance document in order to demonstrate compliance with special licence condition 4M.3. It should outline any longer-term projects or initiatives that are being developed by the ESO and the key milestones and timelines involved. The ESO should clearly explain how these aims and initiatives will deliver consumer benefits. The Long Term vision should seek to maximise overall benefits for consumers across time horizons.

#### *The Deliverables*

- 5.9. The Forward Plan should set out, in relation to each of the Roles, the specific steps the ESO intends to take in Year t to meet its Long Term Vision. The ESO should include a set of Deliverables that relate to the Long Term Vision. The Deliverables for each Role should have sufficient coverage of the supporting guidance in the ESO roles and principles guidance document.

5.10. In general, we consider that the Deliverables should be:

- Specified – it should be clear what is being delivered in practice in order for successful delivery to be measured.
- Time bound – it should contain clear dates and milestones.
- Relevant – they should be justified against the delivery of the Long Term Vision.
- Beneficial for consumers – they should be intended to deliver consumer benefits and make clear what type of measurable outcome/benefit is associated with its successful delivery. The ESO should clearly articulate and/or quantify the expected consumer benefits associated with a Deliverable.
- In line with industry priorities – it should be clear why deliverables have been prioritised and how industry feedback has been responded to

5.11. Any new or updated Deliverables should be clearly identified and outlined in the reporting documents (eg in a separate sub-section), so it is clear where additional amendments have been made in comparison to the original Forward Plan.

5.12. Where the ESO believes a Deliverable goes beyond baseline expectations, it should clearly explain why this is the case by considering how it goes beyond the baseline expectations identified under RIIIO-T1 price control funding (including innovation funding), expectations under the ESO's licence as well as commitments in previous Forward Plans.

5.13. The ESO should also provide the total forecasted internal costs it expects to incur (for each role) in order to meet the proposed deliverables in the Forward Plan.

#### *The Performance Metrics*

5.14. As part of this Forward Plan process, the ESO should propose a set of Performance Metrics linked to each of the roles, making sure there is sufficient coverage of each of the Principles and the supporting guidance in each Role (as described in Table 1), in order to demonstrate compliance with special licence condition 4M.3. These metrics should create transparency around the ESO's performance and help stakeholders track the ESO's progress against its Forward Plan. Therefore, the ESO should finalise the



Performance metrics at the start of the year in the Forward Plan and refrain from making substantial changes to the Performance Metrics during the year.

5.15. Each Performance Metric should also be supported by 'Performance Benchmarks'. These would set out and clearly justify the level of performance that is under, in line with and above baseline expectations, with reference to the baseline behaviours defined by the Principles. An illustrative example of this can be seen in the table below.

5.16. Performance metrics should be:

- Specified – it should be clear how exactly performance will be measured with full details of the metric shared with stakeholders.
- Relevant – the ESO should clearly articulate how the Performance Metrics feed into the Deliverables and how both achieve the outcome identified in the Long Term Vision.
- Benchmarked – performance benchmarks should be challenging with clear evidence provided around how they are challenging (and deliver above baseline expectations). If possible, the ESO should also explain and articulate how this feeds into consumer benefits (which can be described qualitatively and/or quantitatively).

5.17. From 2020-21, the ESO must set out the full details of the Performance Metrics and Performance Benchmarks, including any methodologies used to calculate them. These details must be published as part of the draft Forward Plan and the final Forward Plan.

5.18. The ESO's provision of the information described in 5.10 and 5.16 will determine the extent to which Ofgem is able to provide feedback through its Formal Opinion.

**Example of performance metrics and benchmarks**

Role X			
Performance Metric	Performance benchmarks		
	below expectations	in line with expectations	above expectations
% error in activity	> X%	X-Y%	<Y%
Costs of an activity	>£Xm	£X-Ym	<£X-Ym
Number of instances of X	<X	X - Y	> Y

Stakeholder survey on performance against deliverable	1-5	6-8	9-10
Delivery of a longer term aim or initiative	Description of outcome / evidence to be used	Description of outcome / evidence to be used	Description of outcome / evidence to be used

### Monthly reports

- 5.19. The ESO should publish monthly updates of the Performance Metrics as a default position. However, there may be cases where monthly measurement is less practical (for example, metrics based on stakeholder surveys). In these cases, the ESO should discuss this with Ofgem and stakeholders to determine a more appropriate reporting schedule.
- 5.20. The monthly update of Performance metrics should be in a format that is consistent and comparable to the Forward Plan and presented in Roles.

### Quarterly reports

- 5.21. The quarterly reports should provide narrative around the reasons for the ESO’s performance against its Performance Metrics and an update on its progress against its Forward Plan. This should include any developments in relation to the Deliverables. It should also highlight any particular initiatives where it believes it has gone beyond baseline expectations to deliver additional consumer benefits.
- 5.22. The quarterly reports should be in a format that is consistent and comparable to the Forward Plan and presented in Roles.

### Mid-Year Report

- 5.23. The Mid-Year Report should provide information on the progress the ESO has made against the Deliverables during Q1 and Q2 in Year t. It should include a summary of the ESO’s performance against the Performance Metrics, including the explanations and justifications for its performance. **The ESO should also provide an update on progress it has made against Q3 and Q4 deliverables.** It should also include any evidence of benefits to consumers that either:
- have been delivered during Q1 and Q2 in Year t;
  - or that are due to be delivered in future years due to actions take in Q1 and Q2.

## End of Year Report

5.24. The End of Year Report should provide evidence on the extent to which the ESO has successfully delivered the Deliverables identified in its Forward Plan. This should also include evidence of additional initiatives or benefits created outside of the Forward Plan. It should also include a summary of the ESO's final performance against the Performance Metrics, including the explanations and justifications for this performance. It should include any evidence of qualitative and/or quantitative benefits to consumers that either:

- have been delivered during Year t;
- are due to be delivered in future years due to actions taken in Year t.

5.25. The End of Year report should be in a format that is consistent and comparable to the Forward Plan and within year reports and presented in Roles.

5.26. The end of year report should also consider including the total costs the ESO has incurred for each role over the year.

## Stakeholder evidence and surveys

5.27. Where the ESO provides evidence using stakeholder surveys and/or bases Performance Metrics on stakeholder surveys, the full details of these surveys should be made available to stakeholders, Ofgem and the Performance Panel. This includes details around the method of collection, the precise questions asked, any scripts for telephone surveys and the number of responses received, alongside a summary of stakeholder responses.

5.28. From 2020-21, the details of stakeholder-based surveys should be finalised and published as part of the Draft Forward Plan.

## General standards of conduct on reporting

5.29. This Guidance Document also sets out general standards of conduct that should apply to all reporting performed by the ESO. These are that the ESO must ensure that:

- All reports are accessible and easy to understand, and give prominence to the most pertinent information;

- All reports provide a fair and complete picture of the ESO's performance, including both areas of over and underperformance;
- Due care and attention is taken to ensuring that information provided in any reports are, to the best of the ESO's knowledge at the time of submission, accurate and complete.
- Where the ESO identifies that inaccurate information is being reported, the Authority must be notified and corrections made to the report as soon as practically possible.
- Where material amendments are made to any information provided in a report, these amendments are clearly communicated to stakeholders and the Authority and are clearly identified in the reports
- It takes on board the Authority's and/or relevant stakeholders feedback on the reports and factors this in to the development of future versions (or provides a reasonable explanation for why feedback cannot be included).