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The Electricity System Operator Regulatory and Incentives Framework from April 2018

Dear David,

We are pleased to be invited to respond to this consultation. Citizens Advice has statutory responsibilities to represent the interests of energy consumers in Great Britain. This document is entirely non-confidential and may be published on your website. If you would like to discuss any matter raised in more detail please do not hesitate to get in contact.

We broadly agree with the proposals Ofgem is making in this consultation to implement a new regulatory and incentives framework for the Electricity System Operator (ESO) from April 2018.

We support Ofgem's move towards incentivising long-term decision making by the ESO. To do this we recognise that the ESO needs to remain flexible to meet the challenges over the course of a price control. However, guidance should not replace the transmission licence. We believe that as the price control evolves Ofgem should regularly review where new elements of the ESO's role have become business as usual.

Good stakeholder consultation will be key to including Consumer representatives. We expect to see the ESO make efforts to engage with and listen to consumers directly. The RIIO price control model has been successful at driving improved stakeholder engagement through incentives, particularly in ED1. This consultation is relatively silent on Customer and Stakeholder satisfaction. We would expect the ESO's requirements to improve Customer and Stakeholder satisfaction to be an essential element of any price control or incentives package.

The Performance Panel should consult market participants and ESO Stakeholders on ESO performance - this is not currently mentioned within the consultation. We see a role for the Performance Panel to provide input to the ESO Forward Plan by recommending actions or outcomes based on the performance.

We have outlined answers to the questions in your consultation below.

Question 1: Do you agree with our updated roles and principles for the ESO?

We agree with the roles and principles for the ESO. However, we would like further clarity on the role that the ESO should have to support and facilitate competition in the networks and markets.

We note that these roles and principles are a combination of areas where the ESO has direct control (for example, managing imbalances, or driving transparency in balancing activities) and ones where it only has indirect control or influence (for example, facilitating timely network investments). It will be necessary for the new framework to take this into account, with the aspiration to reward or penalise the ESO for good or bad behaviour or outcomes where it can exert a reasonable degree of control over those outcomes. Where delivery of these roles or principles is partially, or significantly reliant on the decisions made by others, whether network users or network owners, the ESO should not collect windfall gains or losses as a consequence of areas it had limited control over.

Question 2: Do you agree with our proposals for the ESO Forward Plan? Do you think our proposed process for reviewing the ESO's Forward plan will create a sufficient incentive on the ESO to develop a plan and performance metrics that are appropriately challenging and comprehensive?

We support Ofgem's proposals for the ESO to submit a Forward Plan. Full stakeholder engagement is an essential part of this proposal and we believe transmission and distribution users should be represented as well as domestic and non-domestic consumers. It would be desirable for the ESO to make efforts to engage with domestic and non-domestic consumers further which will allow those groups to provide informed input to the ESO Forward Plan.

Question 3: Do you agree with our proposals for within-year reporting? Do they appropriately balance the need for transparency with resource burden for the ESO?

We support Ofgem's proposals for within-year reporting. In our view the reporting requirements seem reasonable and proportionate. As with the development of the Forward Plan, we would expect the 'Mid-Year Review' to engage with a range of stakeholders including domestic and non-domestic consumer representatives, as well as transmission and distribution users.

Question 4: Do you agree with the design of our evaluative scorecard incentive? Do you have views on the Panel scoring criteria or payment-penalty methodology?

We agree with the design of the evaluative scorecard incentive. It is right that the framework of regulation tries to encourage longer term thinking, and Ofgem is acting reasonably in its aim to try and get away from the short term focus that trying to beat within-year targets that the old ESO incentive fostered. But it may be fundamentally hard to judge the value of an initiative initiated in year X, by the judging panel and Ofgem in year X, when the intention of that initiative was to cut costs five or ten years down the line. Ofgem may wish to consider whether some elements of reward or penalty can be rolled over from year to year so the practical results can be seen and that both it and the Performance Panel aren't trying to guess the future.

It will be necessary that rewards or penalties only build up for performance that is materially better or worse than a broadly good ESO would be expected to achieve. The ESO's internal costs are already funded under RIIO-T1 which allows a baseline commercial return and the licensee is already under licence obligations to be efficient and economic. Therefore, the ESO incentive scheme shouldn't be a mechanism that allows bonuses for doing the day job.

Per our recommendations in our report Energy Consumers Missing Billions¹ we would also want to see outperformance becoming bankable - e.g. that if it raises its game it should qualify for bonuses, but that if it keeps performing at that new level it shouldn't get bonuses for that indefinitely; at some point that higher level of performance simply becomes treated as business as usual.

Question 5: Do you agree with our proposed scheme cap and floor of ±£30m?

We neither agree nor disagree with the proposed scheme cap and floor of ±£30m. Some of the seven principles are very much in the ESO's control while others are more dependent on the actions of other market participants. It also seems possible that some 'wins' in one area might be big enough that you might want the ESO to put a heavier weighting on pursuing one, or a number, of the seven principles in any given year. It might be appropriate to apply a degree of flexibility around how the reward is divided up rather than splitting the financial incentive equally between all seven as proposed. One way around this might be to have that equal share approach as the baseline assumption but allow the ESO and Performance Panel to

¹<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/energy-consumers-missing-billions/>

suggest that fractions are flexed in a particular year.

The ESO has an annual running cost of £140m. Although \pm £30m looks very large in that context, we recognise that there's a multiplier effect associated with the ESO. A very good ESO could reduce total system costs by hundreds of millions, and that equally a very bad one could aggravate total system costs similarly - that may make rewards or penalties that large merited. We would expect the cap and floor to be reviewed as the price control evolves.

Question 6: Do you agree with our proposal to introduce a new ESO Performance Panel?

We support Ofgem's proposal to introduce a new ESO Performance Panel. We believe that a well designed panel should provide the required interrogation of the ESO's Forward Plan and performance.

We would expect the panel to consult stakeholders ahead of making recommendations to Ofgem in any given year.

Question 7: Who should sit on the ESO Performance Panel? What is its appropriate size?

We support a Performance Panel made up of industry representatives, independent technical experts and end user representation. We would expect to see transmission, distribution, domestic consumer and non-domestic consumer groups represented. In addition, we believe that new user groups should be represented, such as those utilising new and disruptive technologies. These user groups may change over the course of the price control. We would look to nominate ourselves as the domestic consumer representative.

The consultation was silent on proposals for remuneration of panel members time. We would expect independent panel members to be compensated for their panel work. Likewise, where industry representatives representing a wider section of the industry and not the interests of their immediate employer, we would expect those panel members to also be compensated.

Question 8: Who should chair the ESO Performance Panel?

We support Ofgem's proposal that the ESO Performance Panel should be chaired by an independent chairperson. It is our view that this should happen as soon as possible if not feasible for year one.

Question 9: Do you agree with our proposed approach to implementing our new framework?

We agree with Ofgem's proposed approach to implementing the new framework. We recognise that this approach should allow the ESO to remain flexible over the course of a price control and adapt to new requirements. As 'new' ESO activities become Business As Usual further in to the price control, Ofgem should consider whether it is appropriate to include these activities within the licence in due course.

Question 10: Do you have any comments on our draft licence changes?

We do not have any comments on the proposed licence changes.

I trust that this response is clear, but would be happy to discuss any matter raised within it in more depth if that would be helpful.

Yours sincerely

Stew Horne

Principal Policy Manager, Energy Regulation