

Mr Jonathan Brearley
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Sent via email to: RIIO2@ofgem.gov.uk

Dear Mr Brearley,

RIIO-2 Sector Specific Methodology Annex: Electricity System Operator

I am writing in response to the consultation of the RIIO-2 Sector Specific Methodology Annex: Electricity System Operator (ESO). Overall, Energy UK welcomes the proposals put forward. We believe that the RIIO-2 framework should encourage an ambitious ESO, incentivising it to take appropriate risk to deliver on activities, assisting industry and bringing benefits to consumers. Given the extensive change that the energy industry is going through at present, agility is key to the next price control period.

Post-legal separation, National Grid ESO will be a non-asset rich body. Although timeframes for certain deliverables are enduring, they would not be as consistently time intensive as developing and investing in assets to the degree of Distribution Network Operators (DNO) and National Grid Electricity Transmission Operator (NGET). Therefore, Energy UK welcomes the shorter two-year business plan cycle for the ESO, to incentivise the ESO to deliver on new activities inherent with a quickly evolving GB energy system. This approach would allow the ESO to readdress its priorities and activities more frequently, in-line with the Secretary of States 'After the trilemma - 4 principles for the power sector' speech in November 2018. However, these proposals must not be restrictive of the ESO to develop longer term deliverables beyond the scope of a two-year horizon, and larger activities must be acknowledged in the methodology for incentivisation where the ESO shows the need for these projects to have longer horizons.

While we are supportive of a two-year period for ESO business planning, we recognise that this will have resourcing implications for the ESO; preparing business planning will displace crucial business activities. The process of providing evidence to support incentivised activities is a valuable and a resource heavy part of the ESO's role and by reducing the price control period, we are increasing how often the ESO has to do this. Energy UK does not want to hamper the ESO's efforts to deliver activities that are of importance to industry.

Unlike the other RIIO sectors of the incentivisation scheme, we note that the ESO is unique in that it is also subject to the ESO Performance Panel. This review process provides a further +/-£30 million incentive to the ESO in regards to its beyond baseline activities. We would

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welcome clarity of how the additional framework is justified as a further incentive to the other RIIO sectors.

We believe that recognised activities which have been, or will be, incentivised should eventually become baseline activities in future RIIO periods. Although it is appreciated that there will be ongoing costs associated with the activities, the incentive should be focused on delivery, rather than the ongoing operating expenditure post-incentive.

The roles of EMR delivery body, data administration, and revenue collection functions should be included and accounted for under the RIIO-2 methodology. Energy UK understands that a fundamental review of Energy Code Governance is being undertaken in 2019, and for this reason, any price control arrangements related to the code administrator function of National Grid ESO should be done in such a way that allows for changes to be made. Should the role of code administrator be readdressed and a dedicated code administrator proposed, the RIIO-2 framework should allow for this to take place. The process of a competitive tender for this role would allow for the most appropriate body to be appointed at the least cost to consumers, whilst also freeing resource of the ESO to concentrate on other system enabling activities and deliverables. Should the Code Review recommend that the code administrator functions of the National Grid ESO be tendered, the ESO price control should allow for these adjustments to be made efficiently.

We note that throughout the industry there are significant inconsistencies with regards to the definition of 'whole-system'. Although the considerations of a whole electricity system have been better defined in recent months, the uncertainty of the approach for a whole energy system presents misgivings. Energy UK encourages Ofgem to clearly outline and define what the whole energy system approach should include for the ESO. Considerations of the whole-system approach should include all energy systems (gas and electricity) as well as further systems which are increasingly dependent on the energy systems, such as transport and heat.

We believe that a symmetrical high gain, high loss incentive system will continue to make the ESO risk averse. We encourage the review of the current incentive structure to provide the ESO with suitable incentive to deliver, whilst also reducing the potential negative incentive, to minimise a cautious approach to activity delivery. Energy UK would be welcoming of asymmetrical incentives, where the potential positive incentive outweighs the negative on the condition that it is monitored to ensure that the ESO does not exploit an acceptable risk (loss) approach in certain deliverable areas.

RIIO-GT/GD2 Sector Specific Methodology Annex

Energy UK's Head of Gas, Julie Cox, has been engaging with Ofgem in regards to the gas sector specific methodologies. Below are the overarching themes, representative of Energy UK's views and positions.

- A whole systems approach needs to consider transmission and distribution interactions across both gas and electricity. Any other approach is likely to lead to sub optimal outcomes.
- Consistent assumptions should be used across all sectors and articulated in a way that is easy for stakeholders to understand. This should include levels of demand and decarbonisation approaches. It would make little sense if Electricity Transmission, Gas Transmission and Gas Distribution all had different assumptions as their base case.
- Any work that Ofgem identifies that it wishes to include in RIIO-2 for the networks to progress should start with a problem statement which is fully articulated including the customer detriment. Prescribing solutions rather than problems is unlikely to lead industry supported outcomes that are in customers interests.

- As the energy system is evolving and decarbonising, innovation clearly has a role to play, but there is a question as to how much of this should be business as usual to ensure the future viability of the networks and how much should be funded by customers. In this respect we welcome proposals to remove the Network Innovation Allowance as this had limited transparency for stakeholders and it is not clear how networks are held to account for the revenue received.

If you would like to discuss further any of the above, please feel free to contact me.

Yours sincerely,

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