

By e-mail to: [electricitySOreform@ofgem.gov.uk](mailto:electricitySOreform@ofgem.gov.uk)

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18 January 2018

Dear David, Grendon,

**ELEXON's response to your consultation: 'The Electricity System Operator Regulatory and Incentives Framework from April 2018'**

We welcome the opportunity to respond to the above consultation.

None of this response is confidential, but in line with your request in paragraph 4.13 of this consultation, we are sending our response both: electronically (to reach you by the consultation deadline of 19 January); and by post (which may reach you after the deadline, but will be identical to the electronic version).

As you are aware, ELEXON (as 'BSCCo') is the Code Manager for the Balancing and Settlement Code (BSC). We are responsible for managing and delivering the end-to-end services set out in the BSC and systems that support the BSC. ELEXON is also responsible for EMR settlement arrangements.

Our response (appended below this cover letter) is structured in three sections as follows:

- General comments
- Answers to your specific Questions
- Comments on the draft Electricity System Operator (ESO) Roles and Principles guidance document

The views expressed in this response are those of ELEXON Ltd alone, and do not seek to represent those of the BSC Panel or Parties to the BSC.

If you would like to discuss any aspects of our response, please don't hesitate to contact me at [steve.wilkin@elxon.co.uk](mailto:steve.wilkin@elxon.co.uk).

Yours sincerely,



Steve Wilkin  
European Coordination Manager

## 'THE ELECTRICITY SYSTEM OPERATOR REGULATORY AND INCENTIVES FRAMEWORK FROM APRIL 2018': ELEXON'S RESPONSE

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### 1. General comments

- Where it is possible to do so within the constraints of our various business models, we would seek equivalent treatment for all code administrators including the Electricity System Operator (ESO) under this incentive framework when acting in its code administrator role. Indeed, the ESO's performance might be measured against a benchmark of the 'best in class' code administrator according to Ofgem's code administrator survey results.
- Expanding on, and extending, the above point more widely, we would reiterate a point noted in our response to your working paper issued in July 2017.
  - Ofgem has identified four roles for the Future ESO. In identifying how successful the ESO is in delivering these roles it will be important to understand what should be considered as 'business and usual' and what could drive additional value for stakeholders and consumers over and above 'business as usual'. This will help to clarify for the ESO, the Performance Panel and industry what the minimum expectations are but also how a for-profit but 'more independent' ESO should earn additional revenues (or is allowed to retain funds).
  - If for example, Ofgem (or stakeholders) believes there are roles and services which the ESO should be better at delivering today (which presumably partly drives the need for separation), then should the ESO be additionally rewarded for such improvements or is this improved level of service the minimum expected (even if this requires greater focus and resources than today)?
  - For example, if it is important that the ESO's forecast information and level of accuracy is improved and is more transparent then some measure should be set which states what is expected today before any additional reward is permitted.
  - Or, for example, if the quality of support and customer service associated with the ESO's code management services currently falls below that expected of CACoP and Ofgem or users' current expectations, then should the ESO not ensure the starting point for the more independent SO is to deliver a better service without the need for further incentive to bring the standard up? There is a risk otherwise that the ESO could be rewarded for improvements to services which should have been forthcoming anyway from a reasonable ESO.
- We believe that the ESO should be incentivised to consider whole system solutions so that the options it chooses to initiate or develop are not only ones that deliver an absolute consumer benefit, or ones which utilise the ESO's own systems, but the ones that maximise that consumer benefit. This would include considering the relative benefits of options that the ESO is empowered to initiate or support. For example, through changes to non-ESO owned codes and systems.
  - Practical examples of this could include initiating appropriate BSC Modifications and supporting the continued one-stop shop data publication on the Balancing Mechanism Reporting System (BMRS) to avoid fragmented data publication.
- We believe that the Performance Panel should be held mainly in open session, in the same way as the BSC Panel, to enable the wider stakeholder community to engage with the

incentives process more easily. And the Performance Panel should consult widely on evidence it receives. However, the Performance Panel should be held in closed session: when planning what to ask the ESO; and when deciding on the ESO's performance rating; to allow for a free exchange of views between Panel members.

- We believe that the Performance Panel will need independent, non-profit making, secretariat support. This also suggests that the scope of funding (wider than the remuneration of the 'independent' members) should be considered further.
- To avoid any actual or perceived conflicts of interest, any secretariat support to the Performance Panel should not be drawn from the ESO or National Grid.
- We believe that consultations on the ESO Forward Plan should be fully public and last for a minimum mandated period of 20 working days (or longer if the consultation period includes Christmas and New Year holiday period).

We give more detail on, and supporting evidence for, these comments in the rest of this response.

## 2. Answers to your specific Questions

Below are the ELEXON responses to your specific Questions, omitting those Questions on which we have not expressed a view.

### **Q1: Do you agree with our updated roles and principles for the ESO?**

We agree with the roles and principles, but we have comments on how the ESO should be required to interpret them, as follows.

We believe that Principle 1 ('Support market participants to make informed decisions by providing user-friendly, comprehensive and accurate information'), and to some extent Principle 2 as well, should not be read to mean that the Electricity System Operator (ESO) must automatically develop or favour its own delivery systems in competition with non-ESO systems, e.g. the BSC Balancing Mechanism Reporting System (BMRS).

The ESO should be encouraged to take a whole systems approach to give best value to the consumer (and hence industry). This would also align with: the third role for the ESO ('facilitating whole system outcomes'); and Principle 6 ('coordinate effectively to ensure efficient whole system operation and optimal use of resources').

For example, in relation to Principle 1: the 'when', 'where' and 'how' the ESO publishes data can be as important as 'what' it publishes. This is a principle already recognised in the European REMIT<sup>1</sup> Regulation, which requires inside information, for example, to be published in a way to 'ensure simultaneous, complete and effective public disclosure of that information.' Recent examples, e.g. last summer National Grid began sending out emails of demand forecasts (day ahead; 2 day and 7 day) to industry subscribers, despite the fact that BMRS already publishes much of National Grid's related demand forecast data in one place, suggests to us that this point should be stressed when interpreting the future ESO's principles.

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<sup>1</sup> Regulation (EU) No 1227/2011 on wholesale energy market integrity and transparency

Principle 4 ('Promote competition in wholesale and capacity markets') should encourage the ESO to propose BSC (and other code) Modifications to promote competition. ELEXON is not currently permitted to raise BSC Modifications, so encouraging the ESO to do so should make the BSC (and other codes) more flexible to a changing industry context.

**Q2: 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 have a few questions relating to the implementation of the Forward Plan in the first two years, 2018/19 and 2019/20.

With reference to the consultation document paragraph 3.14, it appears that the ESO Performance Panel is empowered to comment on the draft Forward Plan from April 2019 onwards. What arrangements will there be for reviewing the 2018/19 draft Forward Plan if there is one? And, if the Performance Panel is set up from mid-2018, according to paragraph 3.48, can it not review the draft 2019/20 Forward Plan before April 2019? Although, in answer to this, the draft licence condition 4M.5(c) suggests that it will indeed do so.

With reference to consultation paragraph 3.15, we have a similar question on timings. Ofgem's Formal Opinion is given within the performance period and we wondered whether this was fair to the ESO and to industry if the true incentives are not formally confirmed for the first month of the review period each year. How will this be managed?

**Q3: 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 agree. It largely aligns with our own reporting on a monthly, quarterly and annual basis. The 'Mid-Year Review' is an extra activity but is justified to help align ESO, industry and Ofgem expectations.

**Q4: Do you agree with the design of our evaluative scorecard initiative?**

**Do you have views on the Panel scoring criteria or payment-penalty methodology?**

The ESO is clearly interested in providing evidence that supports a good score and may therefore be less keen to share any evidence that would lead to a lower score. This is entirely natural but we believe that there needs to be a process to mitigate against any inherent bias in self-reporting. We believe that the Performance Panel should have powers to seek further evidence where the Panel believes that evidence already provided does not fully support the ESO's own conclusions on its performance. If the ESO does not, or is unable to, provide this evidence, then this should be taken into account by both the Panel and by Ofgem, and any later evidence provided that the Panel/Ofgem reasonably consider should have been provided in the initial report.

Conversely, the ESO should also be enabled to challenge and comment on any evidence brought forward by others.

On the Panel scoring criteria, we believe that the 'evidence of delivered benefits' should ensure that the evidence includes consideration of whether the options chosen (where there were any) delivered the maximum benefit to consumers. For example, given our sensitivity to the ESO potentially favouring its own reporting systems over BMRS, we suggest that the ESO be asked to provide evidence that the reporting option chosen was the best option. In other words, that the chosen option not only delivered an absolute benefit to consumers, but that it maximised that benefit, out of all the options.

#### **Q6: Do you agree with our proposal to introduce a new ESO Performance Panel?**

Yes, however the makeup of the Panel is key to its success in the process. In particular the ability of those organisations that are not represented on the Panel to put forward thoughts, views and evidence for consideration by the Panel. So we agree with your proposals as set out in paragraph 3.51 of the consultation document.

There are also questions of any secretariat support; and funding both for this and for the expenses of the Panel members in travelling and collecting views from their constituencies.

This is partly addressed in paragraph 3.59 of the consultation, but open questions remain on, for example:

- the expenses incurred by the Panel as a whole in producing the report
- secretariat support (we believe it would be inappropriate for ESO or National Grid to undertake this as the Panel will need to determine questions to ask of the ESO; and to determine and justify the performance ratings for the ESO, probably in closed session to allow a free exchange of views between Panel members)
- which members are considered to be 'independent' for expense purposes (as described in paragraph 3.59)
- whether expenses should be paid to 'non-independents' to ensure that the pool of membership candidates is broad enough
- whether members are voted in by their constituents (to be defined) and how/who would operate and police any voting process.

As an example of where support to the Performance Panel might be required (and hence costs arise), ELEXON has obligations under BSC C3.1.1 to:

- 'provide or arrange the provision of such facilities, resources and other support as may be required by the Panel to enable the Panel or any Panel Committee or Workgroup to discharge its functions and responsibilities under the Code....'

BSC Section C3.1.3 goes on to say that the 'facilities, resources and support' that ELEXON may be required to provide to the Panel, Panel Committees or Workgroups include (not exhaustive list): meeting facilities; the preparation of papers and reports; and arranging for expert advice.

In deciding upon any secretariat support for the Performance Panel, we note that it is unlikely to be a significantly different role from that set out above. And the size and risk of any secretariat role does not justify a new or profit-making body to discharge it. As we noted in our draft 2018/19 Business Plan (currently with industry for comment) in respect of the new Retail Energy Code administrator, the best option is '...to appoint a trusted and respected organisation, such as ELEXON, with the interests of supporting industry, government and the regulator ingrained in its DNA, and on a not-for-profit basis just like the BSC.'

On the operation of the Performance Panel, we suggest that it should have confidential sessions (as noted above) when it is planning what to ask the ESO, or considering the exact ratings to give to the ESO at the end of the year; but that most sessions should be held in open session, particularly where evidence is being gathered and challenged, to allow full stakeholder engagement.

### **Q7: Who should sit on the ESO Performance Panel?**

#### **What is its appropriate size?**

We agree with Ofgem's proposal for Option 3 (a mixed Panel membership) for the reasons you give.

We note the possible membership set out in paragraph 3.55. If Panel members are to be representative, then there must be a means by which they seek the views of their constituency. For that reason we suggest that Energy UK might also be approached to see if it would be willing to take up a membership place as they already have the infrastructure in place to canvass views of their membership.

As part of the ESO role is code administration and data publication, which is also ELEXON's core business, we would also seek a route by which we could comment in order to achieve, where this is possible, a level playing field between ELEXON and the ESO in relation to these tasks. Even though we are not for profit and the ESO will be part of a profit making group, there could still be instances where the ESO favours its own data publication for instance on which we would wish to comment.

We also believe that the Performance Panel should have the power to require the attendance of the ESO in person, for example:

- when the Performance Panel wishes to discuss evidence with the ESO (both ESO's and other's evidence) and to allow challenges to that evidence (in both directions)
- to gain a fuller understanding of ESO's evidence, its relevance to ESO's incentives, and ESO's conclusions
- to request actions of the ESO, e.g. providing further evidence to support the ESO's conclusions.

Without this power, we think that the Panel will be constrained in how efficiently it can undertake the assigned tasks.

### **Q8: Who should chair the ESO Performance Panel?**

We agree with Ofgem's proposals (initially an Ofgem chair moving to an independent chair subsequently) as set out in paragraphs 3.57 and 3.58 of the consultation for the reasons you give.

### **Q9: Do you agree with our proposed approach to implementing our new framework?**

In broad terms, we agree. However, we have two comments of detail:

- In paragraphs 4.3 and 4.8 of the consultation, you mention consulting with 'impacted parties'. The implementation of this is unclear, but if it excludes stakeholders who have an interest and would wish to comment, we would not agree. We would prefer a public consultation on any material changes to the roles, principles and guidance documents.

- Paragraph 4.6 of the consultation sets out the final details that will be included in the guidance document. We believe that the details of stakeholder engagement expected before, during and after the performance evaluation year should also be listed here.

### **Q10: Do you have any comments on our draft licence changes?**

We believe that **Special Conditions 4M.4/4M.5** should specify that:

- the consultation on the Forward Plan is a fully public consultation, rather than a consultation with a specific list of parties (although it may be necessary to specify that the Performance Panel must be informed when the consultation is published); and
- a minimum consultation period should be mandated. A minimum 20 working days (or longer if it includes the Christmas/New Year period) seems appropriate to us. It is important that stakeholders are given sufficient time to review and respond to the draft of the Forward Plan, particularly if the consultation is held over the Christmas/New Year period.

With regard to **Special Condition 4M.9** and as noted in our response to Question 2 above, we question the timing of the Formal Opinion if it means Ofgem's views are not known for the first month of the new performance year.

With regard to **Special Condition 4M.13**, we believe there should also be a public consultation before any material revision. As a minimum the Performance Panel should be consulted in case it interacts with/affects their plans.

With regard to **Part E**, the role of the Performance Panel has been omitted. The reports and information should also be sent to the Panel as the same time as, and as well as, to the Authority in order for it to perform its role.

With regard to **Part G**, 'FP Consultee' appears to be intended to be a defined term, but has been omitted from the list of definitions in Part G.

## **3. Comments on the draft ESO Roles and Principles guidance document**

### **Principles**

With regards to the Principles, see our response to Question 1 above.

### **Overarching comments applying to more than one Role or Principle**

With regards to the continuous improvement of ESO's processes (mentioned, for example, in the bullet point on 'accurate' information on page seven), we think this should include, not only consideration of its own processes, but also how it might, for example, improve other code processes where it has the powers to do so.

We are thinking here that the ESO should be encouraged, when appropriate, to raise BSC (and other code) Modifications where it can see clear improvements. In respect of the BSC, raising Modifications for this purpose is something ELEXON is not permitted to do. ELEXON would like to work collaboratively with the ESO on this.

For that reason, we also support Ofgem's proposal (paragraph 1.24), to encourage the ESO in ensuring the code arrangements promote competition, which in our view would include:

- raising appropriate code Modifications where they are empowered to do so (as suggested in paragraph 1.26 for example);
- actively participating in Modification meetings, and generally contributing to, the Modification process where their expertise is required to identify the best solution from a consumer perspective; and
- actively driving the implementation of their own supporting IT systems to time and budget, particularly where the final approved Modification is reliant on this.

But we think it should not be limited to competitive market matters (Role 2) but to any matter where the ESO can foresee potential or actual consumer benefit that it can initiate or help deliver.

As stated in an earlier response to you, in setting expectations for how the ESO can ensure it facilitates change and improvements through the existing industry codes, Ofgem should ensure the ESO has the right incentives and tools at its disposal to achieve this.

With regards to Principle 2 (paragraphs 1.12 to 1.17) we would note that the ESO will be bound, subject to Brexit, to use certain European balancing products. In general, where the ESO has limited freedom of choice due to legal obligations (EU or otherwise), this should be taken into account in the guidance, but the ESO should still be encouraged to implement the legal obligations in the most efficient way; and perhaps even to propose future amendments to such legislation where it can see clear advantages for the consumer in doing so. Even if the ESO has no formal powers to drive those amendments, particularly in the light of Brexit for EU Network Codes and Guidelines, the fact that it has publicly attempted to raise appropriate changes where these are judged to be of value to the GB consumer, might also be recognised in the incentive framework.

### **Role 1: Managing system balance and operability**

Consistent with our response to consultation Question 1 above, we strongly support the Ofgem proposal set out in paragraph 1.10 of the guidance document that 'the SO should consider the most effective mechanism for publishing information and avoid duplication or fragmentation with established platforms (for example BMRS).'

In conjunction with this, we note that paragraph 1.11 (bullet point on 'user-friendly' publication) includes the phrase 'on its website'. The ESO should not read this as an instruction to always use its own website. But that when it has decided that its own website is the most appropriate publication route for highest consumer benefit, it should follow this guidance. We also believe that the ESO should be required to include, on its 'list' of the information it publishes, pointers to other websites or publication channels where it has opted, or is required, to use those, instead of its own website, i.e. the 'list' should be a comprehensive guide to all its data.

### **Mapping the guidance to Standard licence Condition C16**

We note that the Ofgem guidance refers to actions taken by the ESO inside or outside of the Balancing Mechanism as a bilateral choice. However, with the introduction of European balancing platforms and subject to Brexit, the ESO will have more options/obligations to use different markets to balance, including the EU TERRE platform; the EU MARI platform; the GB Balancing Mechanism; or its own bilateral Balancing Services contracts. We wonder whether Ofgem would wish to reflect this in its guidance.

With reference to the publication of information (Condition (e) on pages 18 &19), we would like to reiterate the points we made above on interpreting the requirement to publish, i.e. that it should be



via the most appropriate communication channel, which may not always be its own website. We think this point should be made explicit in the guidance.

END.