

James Veaney
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Ofgem
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London
E14 4PU

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Dear James,

RIIO-2 Framework Consultation – ELEXON Response

We welcome the opportunity to comment on the questions posed in the above consultation document relating to Ofgem's approach to setting price controls for GB gas and electricity networks.

As you are aware, ELEXON (as 'BSCCo') is the Code Administrator for the Balancing and Settlement Code (BSC). We are responsible for managing and delivering the end-to-end services set out in the BSC, for which we provide Code Manager, Delivery Body and Policy Delivery support. In addition, through our subsidiary, EMR Settlements Ltd, we are the EMR Settlement Services Provider, acting as Settlement Agent for the Contract for Difference and Capacity Market.

Our 2016 and 2017 independent customer surveys achieved our highest ever scores in customer satisfaction and customer advocacy. We were the leading Code Manager across Ofgem's cross-Code survey in 2017. We continue to direct our efforts into customer engagement with all customers. Within the Code Manager role, we provide an end-to-end service (concept, design, implementation and operation). This is efficient and effective (more so than handoffs between different organisations) and has been utilised to great effect by Ofgem.

ELEXON believes that the price control review is an appropriate time to review the wider questions as to what responsibilities sit naturally within the roles of a commercial Electricity System Operator, or a single Transmission Owner, and which roles fit more naturally in an organisation that is independent of the roles of ESO and TO.

We believe that there may be efficiencies to be gained in the standardisation of some or all of the governance of the Customer Engagement Groups. This could be achieved by placing the administration and chairing of these groups under a single body. Clearly, National Grid as the CUSC Administrator would not be an appropriate administrator and chair due to the risk of there being a perception of conflict of interest. We suggest that the BSCCo (ELEXON) would offer a suitable alternative, due to our independence and leading Code Management service.

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 Jeremy.Caplin@elxon.co.uk.

Yours sincerely,



Jeremy Caplin
Market Architect

RIIO-2 FRAMEWORK CONSULTATION – ELEXON RESPONSE

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

Chapter 3 - Giving consumers a stronger voice

Q1. How can we enhance these models and strengthen the role of stakeholders in providing input and challenge to company plans?

- **What are your views on the proposal to have Open Hearings on areas of contention that have been identified by the groups?**

ELEXON welcomes Ofgem's aspiration to seek to strengthen the voice of all stakeholders in challenging the companies' plans.

It may be that there would be efficiencies to be gained in the standardisation of each Distribution company Customer Engagement Group. This could be achieved by placing the administration and chairing of these groups under a single body. Similarly for the Transmission companies, a single organisation running the Groups would offer efficiencies. Clearly, in this case, National Grid as the CUSC Administrator would not be an appropriate administrator and chair due to the risk of there being a perception of conflict of interest. In this case the BSCCo (ELEXON) would offer a suitable independent alternative. Funding for this role would need to be drawn from CUSC signatories.

Our 2016 and 2017 independent customer surveys achieved our highest ever scores in customer satisfaction and customer advocacy. We were the leading Code Manager across Ofgem's cross-Code survey in 2017. We continue to direct our efforts into customer engagement – with all customers. Within the Code Manager role, we provide an end-to-end service (concept, design, implementation and operation). This is efficient and effective (more so than handoffs between different organisations) and has been utilised to great effect by Ofgem.

With regard to Open Hearings, we would suggest that a model similar to the BSC Panel may be appropriate, where meetings are open by default and only move into closed session where commercially confidential issues are being discussed. We agree that the Customer Engagement Group should have the authority to establish sub groups, including Open Hearings on specific issues, should they wish to do so. Again this would be more readily achieved if the administration of the Customer Engagement Groups is external to the company.

We would also propose that data analysis in support of the Customer Engagement Groups should be performed by the administrator / facilitator function rather than placing the burden of demonstrating an impartial analysis on the individual company.

Chapter 4 - Responding to how networks are used

Q2. Do you agree with our preferred position to set the price control for a five-year period, but with the flexibility to set some allowances over a longer period, if companies can present a compelling justification, such as on innovation or efficiency grounds?

- **What type of cost categories should be set over a longer period?**
- **How could we mitigate the potential disruption this might cause to the rest of the framework?**
- **What additional measures might be required to support longer-term thinking among network companies?**
- **Do you instead support the option of retaining eight-year price controls with a more extensive Mid-Period Review (MPR)?**
- **What impact might the alternative option of an eight-year price control with a more extensive MPR have on how network companies plan and operate their businesses?**

Given the pace of change in the industry, and the innovation being supported by advances such as Ofgem's and ELEXON's sandboxes, we agree that five years is an appropriate period.

Q3. In what ways can the price control framework be an effective enabler or barrier to the delivery of whole system outcomes?

- **If there are barriers, how do you think these can be removed?**
- **What elements of the price control should we prioritise to enable whole system outcomes?**

Ofgem is already aware that price controls will drive commercial companies to adopt the solutions that provide the best income for them under the price control. Innovations such as the Customer Engagement Groups will be helpful in that they direct the companies towards the best solutions for the end customer. In particular, if they have the power to propose to Ofgem changes within the price control period.

Q4. Do you agree with our minded-to position to retain the current start dates for the electricity transmission and electricity distribution price controls, and not align them?

Yes. ELEXON recognises the advantages in not aligning the price controls.

Q5. In defining the term 'whole system', what should we focus on for the RII0-2 period, and what other areas should we consider in the longer-term?

- **Are there any implementation limits to this definition?**

Given the rise in distributed generation and initiatives such as community power projects, the term whole system should be construed as widely as possible to cover all electrical systems connected in any way and at any voltage to the national electricity system. In particular the distinction between Transmission and Distribution may change in future years, and could become geographical rather than voltage based. It is logical to imagine a scenario where a Distribution System Operator operates all the system within a geographical area, regardless of voltage, while a Transmission System Operator operates all links between geographical areas, regardless of voltage.

Q6. Do you agree with our view that National Grid's electricity SO price control should be separated from its TO price control?

ELEXON agrees that National Grid's SO and TO price controls should be separate. Over the next five years the role of the national Transmission System Operator is likely to evolve significantly, and is likely to become more and more distinct from that of any transmission apparatus owner.

We do note the difficulties that such a separation could cause National Grid in terms of being able to demonstrate business separation and being able to prove that there was no cross subsidy between the two divisions, particularly where co-located. A split price control would need to ensure that all parties had a common understanding of exactly which responsibilities and costs sat with the SO or the TO.

Q7. Do you agree that we should be considering alternative remuneration models for the electricity SO?

- **If so, do you have any proposals for the types of models we should be considering?**

One solution that can be considered, is that the electricity SO receives no profit and therefore becomes a not for profit organisation. Profit or reward should be in return for risk. It is not clear under the current proposed arrangement that the SO is taking sufficient risk to deserve a margin.

As it stands the SO performs two largely distinct roles: a pure system operator, ensuring that generation meets demand and ensuring security of supply; and a strategic, advisory role providing support to government and the Regulator, as well as administering the Grid Code and the CUSC. This second role need not sit within a System Operator, and could sit with any central organisation trusted by the industry/Ofgem/consumers. It would make sense for these two roles to be recognised and remunerated separately in order to improve transparency in understanding how National Grid SO allocates the funding it is given.

We recognise that our starting point is different code administrators have different business models and that the ability to change things in the short term may be limited. But we feel compelled to ask whether consumer value is best achieved by paying the ESO to come up to the ELEXON 'best in class' standard of code administration? In a normal competitive market, it would seem strange to use public money to reward those delivering a lower level of service.

Q9. What options, within the price control, should be considered further to help protect consumers against having to pay for costly assets that may not be needed in the future due to changing demand or technology, while ensuring companies meet the reasonable demands for network capacity in a changing energy system?

A potential solution would be for funding of assets to be based on utilisation of the asset. This would mean that consumers would not pay for assets that were not used, and would place the onus on the asset owner to ensure that only appropriate assets were built. It could also encourage innovation on the part of the asset owners to consider alternative solutions to building more assets.

Q10. In light of future challenges such as the decarbonisation of heat, what should be the role of network companies, including SOs, in encouraging a reduction in energy use by consumers in order to reduce future investment in energy networks?

- **What could the potential scale of this impact be?**

In addition to encouraging a reduction in energy use, the challenge is also to encourage a reduction in high carbon energy use.

It is noted that Transmission Losses mean that it could be argued that National Grid is the largest user of electricity in the country, with around 2% of all generated electricity being lost on its network. The Distribution companies would not be far behind, with higher percentage losses on a lower total volume of energy. Requiring the companies to pay for the carbon lost on their networks to Transmission or Distribution losses would ensure that the true cost of actions were considered.

Chapter 5 - Driving innovation and efficiency

Q11. Do you agree with our proposal to retain dedicated innovation funding, limited to innovation projects which might not otherwise be delivered under the core RIIO-2 framework?

Innovation funding has been a successful way of moving a number of projects forward. Care should be taken to ensure that the funding is used so as to benefit the consumer who ultimately pays for the work, and not to pay for research to boost a company's profits, nor as a way of funding cheap resource to do core RIIO work.

Consideration could be given to requiring some or all of the money to be used in research organisations such as universities rather than commercial companies. The amount of money that the Transmission and Distribution companies can take for themselves from the innovation funding should be strictly limited.

Companies should not be paid twice for the same work. For example, it is inappropriate for a company to be given an incentive to deliver a better outcome, such as an improved forecast, and then use innovation funding to pay for the work necessary to achieve a reward from the incentive.

We also note our response to the recent [Informal Consultation on ESO Licence Drafting](#) questioning the allocation of Network Innovation Competition funding to National Grid as SO, when other non-TO organisations such as ELEXON are excluded.

Q12. Do you agree with our three broad areas of reform: i) increased alignment of funds to support critical issues associated with the energy transition challenges ii) greater coordination with wider public sector innovation funding and support and iii) increased third party engagement (including potentially exploring direct access to RIIO innovation funding)?

ELEXON agrees with these areas.

Q13. What are the key issues we will need to consider in exploring these options for reform at the sector-specific methodology stage, including:

- (i) What the critical issues may be in each sector and how we can mitigate the bias towards certain types of innovation through focusing on these issues?**
- (ii) How we can better coordinate any dedicated RIIO innovation funding with wider public sector funding and support (including Ofgem initiatives such as the Innovation Link and the Regulatory Sandbox)?**
- (iii) How we can enable increased third-party engagement and what could be the potential additional benefits and challenges of providing direct access to third parties in light of the future sources of transformative and disruptive innovation?**

Much technological innovation is being driven by worldwide opportunities and so has not needed RIIO innovation funding. The problem comes with implementation of innovation, and of innovating in a regulatory space.

There is an argument to support a levy being taken from all of the Transmission and Distribution companies to fund third party innovation, in particular making full use of the opportunities afforded by the Ofgem and ELEXON Sandboxes.

Q14. What form could the innovation funding take.

- **What would be the advantages and disadvantages of various approaches?**

RIIO innovation is funded by the end consumer. This may take many steps, with companies passing costs on through, from National Grid to Supplier to consumer for example. It may be less administratively expensive for the same money to be taken explicitly from the end consumer in the form of an innovation charge that is then released by Ofgem or some other body to fund the best innovation projects.

Care must also be taken to avoid duplication of effort, with different organisations initiating very similar research projects at the same time.

Q15. How can we further encourage the transition of innovation to BAU in the RIIO-2 period? How can we develop our approach to the monitoring and reporting of benefits arising from innovation?

Successful innovation should naturally transition to BAU, as it will offer an improvement on existing BAU. Evidence should be required of successful transition to BAU as part of the reporting cycle.

It is recognised that by its nature, innovation carries risk and so some percentage of innovation spending should be expected to fail and not transition to BAU. However, the majority of projects should be successful. It would be possible to introduce a process whereby all projects have to report on their transition to BAU. If a company is unable to demonstrate an adequate percentage of projects transitioning to BAU, or those projects that transition failing to produce any savings, then the innovation allowance could be withdrawn, or even recouped.

Chapter 6 - Simplifying the price controls

Q31. How can we best improve the suite of annual reporting requirements to be as efficient and useful as possible?

Ideally a neutral and unbiased account of the performance against the incentives should be produced by an independent body, based on independent analysis of the raw data. Where this is not possible, comprehensive audits should be performed in order to give all stakeholders confidence in the accuracy and transparency of the results.

Q32. How can we make the annual reports easier for stakeholders to understand and more meaningful to use?

In addition to the main reporting, there should be a simple single page summary of performance against every incentive and target, clearly setting out the outcome of the incentive.

Chapter 8 – Next Steps

Q49. Are there any sector-specific issues or policy areas that we should ensure we review and consider as we develop our sector-specific proposals?

ELEXON believes that the price control review is an appropriate time to review the wider questions as to what responsibilities sit naturally within the roles of a commercial Electricity System Operator, or a single Transmission Owner, and which roles fit more naturally in an organisation that is independent of the roles of ESO and TO.