

Electricity System Operator RIIIO-2 Stakeholder Group (ERSG)

Meeting 3 - 30th January 2019

Amba hotel, Charing Cross, London

Minutes

Attendees

ERSG members

Angelita Bradney	ESO – Company rep
Peter Emery	Electricity North West (interim Chairperson)
Toby Ferenzci	Ovo Energy
Sophie Hind	Technical Secretary
Stew Horne	Citizens Advice
Alan Kelly	Scottish Power Transmission
Andy Manning	Centrica
Catherine Mitchell	University of Exeter
Charlotte Morgan	Chairperson
Kayte O’Neill	ESO – Company rep
Eddie Proffitt	Major Energy Users Council (MUEC)
Simon Roberts	Centre for Sustainable Energy
Fintan Slye	ESO - Company rep
Jamie Stewart	Citizens Advice Scotland
Nigel Turvey	Western Power Distribution
Chris Veal	Transmission Investment
Barbara Vest	Energy UK
Matthew Wright	Orsted

ESO Support

Kashia Anderson	ESO - Observer
Louise Clark	ESO-Observer
Alice Etheridge	ESO - Presenter

Charlotte sent apologies that she would arrive late to the meeting. Peter Emery was elected as interim chair.

1. Conflicts of Interest (all)

The Chair invited feedback on whether members had identified potential Conflicts of Interest relating to the proposed agenda. No potential conflicts were raised.

2. Introduction, Minutes and Actions (Kayte O’Neil, Peter Emery, Sophie Hind)

Open actions were reviewed and updates were given. Details included in updated Action Log.

On action 1.7 (Using Scenarios) the ESO fed back that they had general support from Ofgem on approach of using of scenarios. The Challenge group have said they need to see what is being proposed with more granularity. A letter has been issued from challenge group to the scenarios group requesting a single scenario.

ERSG questioned why the Challenge Group want to go back to using a single scenario as this seems to be a change in viewpoint

The ESO understands the chair of ERSG has been asked by the Challenge Group if the group can review the work of the scenarios group (the request has been made to the chairs of the TO user groups). It was felt that this could be a significant burden on group.

Action: ESO to discuss input of ERSG into scenarios work and what might be required with chair.

3. Forward Look (Kayte O'Neill)

The presenter talked through the schedule of future ERSG meetings and the planned content for each of these meetings. The content of future meetings will involve more technical discussion. Other members of the ESO leadership team will be joining the group to discuss each principle area in some more detail.

The presenter highlighted the ESO's decision to publish an ESO document in March to give stakeholders an early view. It was also highlighted that there are 4 weeks between Ofgem's sector specific decision and the publication of the ESO draft business plan in July. These timelines are tight. The group asked how they can help to ensure that these timelines are not squeezed further, and the ESO responded that it's important to communicate to Ofgem any areas of concern in the consultation during the session today.

The group noticed that principle 7 was absent from the content of future meetings, and it was concluded that it needs to be added for discussion on a future date to demonstrate that it will be discussed.

Action: ESO to include Principle 7 for discussion at a future meeting on forward look slide.

4. ESO RIIO-2 Ambition (Kayte O'Neil)

The presenter talked through the ESO's emerging thoughts on the ambitions for RIIO-2 ahead of the March document. The group were invited to give feedback on the following areas:

- Has the ESO covered the right areas?
- Do you agree with the role the ESO wants to play?
- Is the level of ambition right?
- Does the ERSG have views on the kinds of activities the ESO has proposed to deliver this ambition?

It was recognised by members of the group that the presentation by ESO was a good framework, which needs to be developed with further detail in the publication in March.

The group felt that the ambitions need to reflect the ESO taking more of a leadership role, particularly in the energy transition. The statements lack goals which are measurable and performance related. It needs to be much clearer what the ESO should achieve.

It needs to be visible that the ESO is making progress in the areas of ambition and so benchmarking is needed (e.g. how reliable, affordable and sustainable are ESO now compared to 5 years' time)?

The group struggled to differentiate what the ESO is doing already compared to what is stated in the ambitions. There was a general feeling that the ESO must be more ambitious. It was questioned whether affordability should be explicit in the Mission Statement.

A concern was raised about the more powerful role that the ESO would need to play in the future, and the fact that ESO is still part of the National Grid group. This means it is important to ensure that the ambitions are convincing, focussed, transparent and being executed in the right way.

There are parts of the ambitions (for example a "one stop data shop") that would require support from Ofgem, in ensuring that the appropriate legal obligations exist which allow this to happen. It would be of tremendous benefit to the market.

The statements in the ambition could be more goal oriented by linking them to the Future Energy Scenarios. The Climate Change Act is an existing piece of legislation with legally binding carbon targets which provides a mandate for change. The ESO could take a stronger role in this and be more goal-oriented. Within the four energy scenarios it could be recognised which outcomes for GB would be a failure and which a success; which is the ESO supporting and how are they helping to achieve this outcome?

With the Energy Transition ambition, ESO could go one step further and engage directly with consumers. No one is currently having this debate directly with consumers. Concerning the data ambition, the ESO could be more specific in articulating how the data would be published, what it could be used for and how you would ensure that people are able to use it. For the codes ambition, the ESO needs to be faster and serve consumers and so the ESO needs to drive transition through the codes, and go beyond just stepping up to the code manager role. It is felt that someone needs to step up and lead the industry in the energy transition, and some of the group felt that this should be the role of the ESO. However, it also needs to be demonstrated that this is what the stakeholders (& consumers) want.

The tone of voice and style of the ambitions could be worked on to reinforce the independence and transparency of the ESO. This would also help to clarify which parts of the ambitions are different and new.

Fintan Slye took the opportunity to summarise what he had heard from the group. The ESO needs to increase the ambition and work on the style and tone of the ambitions document. On the energy transition, how does the ESO take and articulate more of a leadership role and be more concrete about the outcomes that it is trying to achieve. The document should use collaborative words but be more specific. On independence, the ESO can articulate how it is sufficiently independent, and the onus is on the ESO to demonstrate how it is doing this. The

suggestion on consumer engagement is an excellent one, and it seems that there is general agreement in the room that this is a good idea.

5. Stakeholder Engagement across the piece (Alice Etheridge)

The presenter explained the purpose of this item; to help with writing the stakeholder report. What have ESO done on stakeholder engagement to date plus what they will be doing going forward.

ERSG members were asked to advise of their expectations for stakeholder engagement and whether the ESO is meeting them, and where improvements might be made.

There was strong agreement that a lot of engagement had been done so far by the ESO. It feels as though engagement activities have been quite ad-hoc, and there is a lack of evidence of a programme with a clear structure. It's difficult to comment on how well the engagement has been executed. For example, has the ESO reached all stakeholder groups?

Examples of strong stakeholder engagement from other sectors / industries were shared. For example, similar activities in the water sector have evolved to show thread of engagement throughout. It's clear that a solid process has existed all the way through where you know that the business plan has been demonstrated. Another idea is engagement logs which detail strategy and process, which stakeholders are targeted and why, and what methods have been chosen because of this. An independent body could be involved in this. A stakeholder engagement presentation by the Financial Conduct Authority (FCA) recognised that a lot of people who are interested won't necessarily take time to respond to surveys, and that they needed to go and see them and ask what their issues were. For the ESO, it's about what will enable them to meet societal needs. What is going on in the wider eco-system that the ESO has a key role in? It was recognised that it is important for the ESO to look at leaders in this area; both internal and external to the energy industry. It was suggested there could be a role for an independent review of the ESO's stakeholder engagement.

It must be evident that the ESO is addressing different categories of stakeholders. Due to the amount of change in the industry smaller organisations are stretched, so there's a risk of receiving biased information from large organisations that can resource more engagement. Identify stakeholder groups and think about it from their perspective. Make sure that they're aware of the impacts of RIIO-2 on them as a stakeholder group. A pie chart summarising who has been consulted would be a good start for demonstrating this. It is also important for the ESO to consolidate engagement where possible, to reduce the burden on smaller organisations.

6. Ofgem's sector specific consultation (Kayte O'Neil)

Charlotte Morgan joined the meeting during this item and resumed the role of chair

The ESO's initial assessment of Ofgem's consultation proposals was presented. The presenter summarised where further clarification is needed as well as the two main areas of concern for the ESO. These are:

- Length of price control
- Funding model and incentives.

The ESO sought the group's views on Ofgem's proposals, ESO assessment and alternative proposals:

- As a customer to the ESO, how would you be affected by Ofgem's / ESO's proposals?
- How would consumers be affected by them?
- In your view, what additional arguments are there for / against Ofgem's proposals?

The group asked the ESO to summarise the current incentives process:

- The ESO writes the forward plan and sets out specific actions (baseline vs above and beyond). Where they have gone above baseline activities and consumer value has been generated, the importance of this is assessed.
- The ESO has an opportunity to present their progress at the half-year and end of year stages.
- There is a panel that reviews the work – the Performance Panel (this panel has not been involved throughout the year)
- There is a scoring system on a scale of 1 to 5 which dictates where on the plus or minus £30m incentive scale the ESO is positioned (a score of 3 roughly equates to a neutral outcome). The panel give their score and Ofgem reviews this and decides on the outcome.

The ESO's concern is that they don't have visibility of this process until the end, and the process itself is fairly resource intensive. The group feel that this is an odd process which doesn't feel like it's based on evidence. The ESO confirmed that it doesn't really have the opportunity to challenge during the process.

The ESO was asked why it doesn't feel that it should play an increased role in the extension of competition in onshore transmission build. The concern is how the roles are divided in the process of competition for network solutions. The concern is if the ESO is asked to take on the role of consenting projects that a competitively appointed TO then builds. . The ESO doesn't have the skills to carry out the consenting work and associated engagement on this. It will then also be in the public's minds that it is an ESO project, when the ESO wouldn't have any control over the delivery of it. The reputation of the company would rest on something that they can't control. ERSG questioned if another entity performing the same role would have similar problems, and if not ESO then who could fill this role?

Feedback on length of price control

Agreement that ESO concerns around a 2-year price control are valid

There must be some fundamental issues that lead Ofgem to believe that a 2-year price control is the best way forward. The ESO believes that the reasons for this are:

- The world is changing quickly. Locking in a 5-year price control might restrain the ability of the ESO to respond to change
- This is the first separate price control for the ESO. Ofgem doesn't want to get it wrong and so there is a degree of caution and risk aversion in the approach.

ESOs response to these concerns is:

- Yes, the world is changing, but broadly the responsibilities of the ESO will remain the same over the next few years. When the ESO reviewed their cost base, the core role accounts for 85% of these costs.
- A 5-year control could make sense. However, Ofgem's proposal is 2+2+1 years, to be synchronised with the TO price control.

The chair added that similar concerns around the length of price control came up during the Challenge Group, and the risk associated with not giving the ESO enough stability.

The point was made that the ESO should be performing as though they have a future despite the 2-year price control.

ERSG asked if it is important for the ESO price control to be linked to other controls in NG. The ESO confirmed that this was not important. The group discussed that it perhaps made more sense to have the control aligned with other SOs (i.e. DSOs in future) than to be aligned with the TOs so the ESO can support other price controls rather than focusing on their own. The link between capital costs and constraint costs at a transmission level was raised as an argument for alignment.

Feedback on Funding model

The presenter explained Ofgem's preference for splitting the model into funding for activities (layered model) and having different margins for different activities depending on level of risk. With the cost pass-through model, Ofgem believe that this will allow the ESO to be flexible and agile. The issue is that this would be combined with cost disallowance, and the potential for incentive downsides could drive risk averse behaviour from the ESO.

ERSG felt that the 2-year price control period along with justification that would be required for cost pass through would create a huge burden for ESO. Ofgem believe that the cost pass through will help with getting around some of the issues associated with a 2-year price control, but the issue for ESO is the architecture that you're putting around that. ESO would feel the need for Ofgem sign off on every penny that is spent.

ERSG agree if Ofgem were able to dis-allow spend ex-post, it would make a company risk averse and focus would shift to avoiding disallowance.

The chair asked ESO what the impact would be if they were exposed to a £30m downside on incentives. ESO returns recently have been around £30m through incentives and totex efficiencies. Therefore, this would create a very risk averse enterprise.

The ESO and ERSG believe that Ofgem doesn't intend to create a very risk averse ESO, but that this isn't consistent with their price control proposals.

The chair asked about potential impact of this on the ESO credit rating, as credit agencies are currently very nervous about regulatory risk. The ESO has not yet had conversations with credit agencies about a 2-year price control, but feel nervous about the impact it could have.

One member felt that the ESO needs to become more of a technology company that can efficiently operate markets. Investments like these aren't one off, and ESO will need to build in-house capability. These will be long-term investments and the company will need to be confident in building up this cost base, and so you need a mechanism that allows them to do this.

There was a view that the funding model sounds similar to the Data Communications Company, which does not currently appear to be working.

The chair asked ERSG to keep an open mind when hearing from Ofgem in the afternoon

7. Ofgem sector specific consultation – Ofgem closed session

Grendon Thompson and Barry Coughlan from Ofgem presented an overview of the proposed ESO price control in a closed session without ESO representatives.

8. Ofgem's sector specific consultation- ESO questions and answers (All)

The chair summarised the key points from the closed session with Ofgem, for the benefit of ESO representatives. Discrepancies between the ESO's concerns and how Ofgem had summarised their proposals were highlighted around the length of the price control and the funding model.

Ofgem had previously made it clear to the ESO that what they were proposing was a 2-year price control. However, ERSG concluded that Ofgem had described a 5-year price control with two year "resets" during the closed session. There was consensus that this is now what had been written in Ofgem's consultation document. During the closed session Ofgem acknowledged that they may not have got their messaging clear in the document.

During the closed session Ofgem had explained that disallowance of costs would only be used in extreme circumstances. The ESO explained that Ofgem have disallowed very large costs in the past, which is a concern.

Action on ERSG to produce a summary of what has been heard from ESO and Ofgem and identify where there are differences. To be written up by the Chair and shared with ERSG, the ESO and Ofgem.

9. Closed Session – (Charlotte Morgan)

The Chair facilitated a closed session without ESO representatives, where ERSG members summarised what they had heard throughout the day.