ofgem Promoting choice and value
for all gas and electricity customers

# SO incentives from 2013

2 February 2012

# Context

- We published a consultation on the principles and policy for SO regulation from SO 2013 this week
- The document set out our views at a high level on regulation of the SO from 1 April 2013
- The consultation period will run for eight weeks and should be emailed to soincentives@ofgem.gov.uk
- If you have any questions on SO regulation following this meeting please contact mathieu.pearson@ofgem.gov.uk or lisa.martin@ofgem.gov.uk

# Objectives for SO and TO regulation

- Overall objectives for SO and TO are very similar, therefore propose common approach to regulation

**RIIO-T1**

1. To play a full role in the delivery of a sustainable energy sector.
2. To do so in a way that delivers value for money for existing and future consumers.

**SO2013**

1. To play a full and active role in the delivery of a sustainable energy sector (integrated with the EU market).
2. To operate electricity and gas systems at value for money for existing and future consumers.

Common principles for monopoly regulation

Aligned objectives

SOs and TOs face similar challenges and uncertainties meeting these objectives

# What we mean by "SO"?

**SO core responsibilities**

**(covered by SO incentives)**

- Delivery of reliable and economical system operations - e.g. system balancing and constraint management

**SO additional responsibilities**

**(mostly not covered by current SO incentives, some addressed by RIIO:T1)**

- Wide range of additional responsibilities include:
  - facilitating connections,
  - system planning (with TOs)
  - charging
  - providing information to the market

**SOs and TOs' roles overlap in a number of areas**

- Boundaries between SO and TO not always clear
- SOs & TOs have joint responsibility in a number of areas

# What do we want SO to do?

Take a proactive approach, e.g. in connections, demand side response etc

Anticipate future developments and facilitate a smooth transition to a sustainable energy sector

Deliver long term value for money in system operations

# Overview of SO regulatory framework from April 2013

- Principles, policy and objectives set for 8 years
  - Some incentive schemes may be set for shorter periods but overarching approach will not change
- Output incentive schemes
  - The SO regulatory frameworks will be outputs led
  - We have set out what outputs the SOs will be held to account to deliver and how we will incentivise them
- Cost incentive schemes
  - The SOs will be incentivised to deliver outputs at long term value for money though cost incentive schemes with associated cost targets
- SO-TO interactions
  - The frameworks will encourage the SOs to work with the TOs to identify behavioural changes that could result in overall lower costs of output delivery for consumers
  - The framework will promote transparency of interactions between SOs and TOs

# SO role: the known unknowns

- The role of the SO in EMR
  - In the technical update published by DECC has indicated the SO will be the body responsible for delivery of FIT CfDs and capacity mechanism
  - DECC has announced the launch of a joint DECC/Ofgem project on the conflicts of interest and synergies between the new and existing SO functions and other National Grid businesses, this work may have implications for SO incentives
- Ofgem’s mandate to review gas security of supply may lead to changes to the role of the gas SO
- Potential changes to the SO role from conclusion of joint DECC/Ofgem co-ordination project
- All of these issues require substantial work during 2012 and conclusions may not be clear in time to incorporate in SO 2013 proposals
- In cases of significant change, regulatory framework will need to be able to adapt accordingly

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# Appendix: SO incentives from 2013

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# Electricity SO outputs

**Balanced system**
Demand meets supply recognising network conditions. Frequency is maintained

**Connections**
Timely completion of applications in accordance with connections process

**Stakeholders satisfied**
Satisfaction of stakeholders: generators, those seeking connection, large users, suppliers, other TSOs and aggregators

**Provision of information**
Provide timely information on key issues relevant to market

**Safety**
Compliance with health and safety standards and voltage is maintained at +/- 5% for 400kV, +/-10% for 275kV and 132kV

**Environmental impact**
Impact of operation on the environment and contribution to broader environmental targets

**Reliability and availability**
Ensuring that the network is available and is developed in a safe, co-ordinated and sustainable manner

# Gas SO outputs

**Balanced system**
Demand equal to supply on a daily basis subject to linepack and system pressures

**Safety**
Compliance with health and safety standards and safety case

**Connections**
Timely completion of applications in accordance with connections process

**Provision of information**
Provide timely information on key issues

**Environmental impact**
Impact of operation on the environment and contribution to broader environmental targets

**Stakeholders satisfied**
Satisfaction of stakeholders: shippers, large users, electricity SO, other TSOs, storage, LNG and interconnector owners and those seeking connections

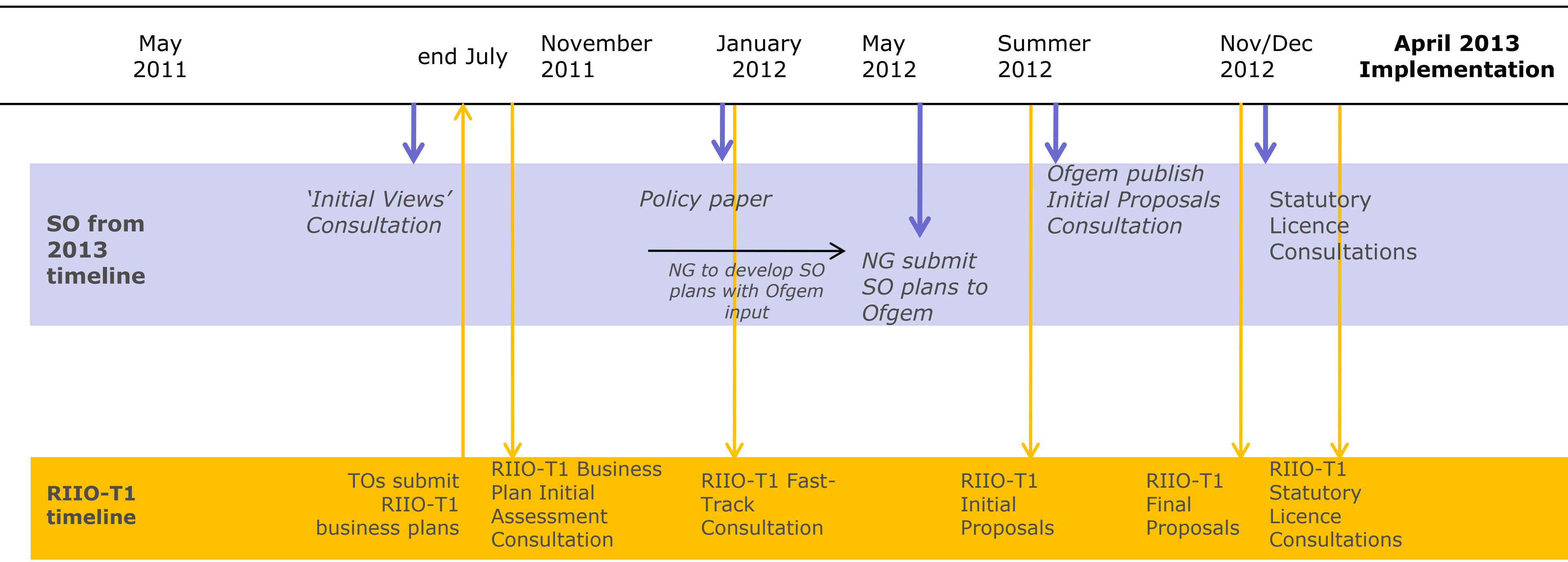
**Reliability and availability**
Capacity is available such that gas can flow at the right quality and pressure

# Cost Schemes

| Electricity | | |
|---|---|---|
| | **Scheme length** | **Cost target methodology** |
| Total balancing costs (bundled) | 4+4 | As per now, with refinements of cost drivers and modelling |

| Gas | | |
|---|---|---|
| | **Scheme length** | **Cost target methodology** |
| Shrinkage cost (bundled) | 8 years | As now, volume forecast multiplied by reference prices |
| OM cost (bundled, with utilisation costs potentially carved out above a certain value) | 8 years | To be determined, e.g. target could reflect past tender prices for OM with an efficiency factor applied |
| **Potential** Balancing cost | To be determined | |

# Timeline


May 2011
end July
November 2011
January 2012
May 2012
Summer 2012
Nov/Dec 2012
April 2013 Implementation
SO from 2013 timeline
'Initial Views' Consultation
Policy paper
NG to develop SO plans with Ofgem input
NG submit SO plans to Ofgem
Ofgem publish Initial Proposals Consultation
Statutory Licence Consultations
RIIO-T1 timeline
TOs submit RIIO-T1 business plans
RIIO-T1 Business Plan Initial Assessment Consultation
RIIO-T1 Fast-Track Consultation
RIIO-T1 Initial Proposals
RIIO-T1 Final Proposals
RIIO-T1 Statutory Licence Consultations

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