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Your ref

Our Ref

Date
15th March 2023

Contact / Extension
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Dear Anna,

Consultation on the RIIO-2 System Operator Transmission Owner Output Delivery Incentive (SO:TO incentive)

This response is from SP Transmission (SPT) which holds the transmission licence for the south and central Scotland. SPT is part of SP Energy Networks (SPEN) and the wider Iberdrola group.

We have been working alongside the ESO and Ofgem to deliver and support the evaluation of the trial SO:TO incentive during the last two years. We welcome Ofgem's consultation ahead of the end of year two of RIIO-T2, and we appreciate the timely publication of this consultation to support the transition to year three of the incentive. We strongly support Ofgem's intention to extend the trial incentive scheme for the remainder of RIIO-T2, and we welcome the decision to remove the incentive cap to unlock increased consumer and system benefits. We have comments in relation to the proposed changes to the incentive mechanisms, as well as the treatment of schemes delivered in year two of the incentive trial, which we set out in Appendix 1 below.

We will also be providing feedback to Ofgem on the trial incentive period via the Final ODI Report on 31st March 2023, as per SpC 4.7.11 in SPT's RIIO-T2 Transmission Licence, to reflect on the benefits and operation of the scheme during the trial period. Based on the evidence collected during the trial period for the SO:TO Optimisation Incentive, SPT remains strongly of the view that the incentive is delivering significant consumer value in reducing constraint costs whilst enabling additional efforts and resources to be dedicated to delivering collaborative solutions with the ESO.

We look forward to working with the ESO to further develop solutions throughout RIIO-T2 to further reduce constraint costs for GB consumers. Please don't hesitate to get in touch if you would like to discuss any of the issues in this response.

Yours sincerely,

Lynne Bryceland
Head of Transmission Regulation and Policy

Appendix 1

Question 1: Do you agree that the SO:TO Optimisation ODI has delivered positively for consumers in year 1 of the trial?

We strongly agree that the SO:TO Optimisation ODI has delivered positively for consumers throughout the trial incentive period. Consumers have seen constraint cost savings, many times greater than the cost of the solution delivery and incentive reward, which would not have happened without the incentive. From a system perspective, the solutions we have delivered have also provided the ESO with an increased set of options for managing the system and reducing constraints, protecting consumers from constraint costs, and from the risk of constraint costs even where they do not occur.

Question 2: Do you agree that it is in consumers' best interests for the SO:TO Optimisation ODI to continue to operate for the remainder of RIIO-2?

The trial incentive period has enabled the TOs to dedicate additional focus and resource to the identification and delivery of optimisation schemes under STCP11.4. This work is beyond business-as-usual and has seen significant growth in the number of schemes proposed and delivered as a result of the incentive. We therefore strongly agree that extending the incentive for the remainder of RIIO-T2 is in consumers interests, particularly given that the benefits secured from reduced constraint costs savings are significant and that there is almost no risk to consumers associated with the incentive, due to structure of the incentive with the 90:10 benefits sharing factor between consumers and TOs.

Question 3: Do you agree with our assessment that there are some aspects of the ODI that could be improved to increase the benefits for existing and future consumers?

We believe that changes are required to the reporting of the incentive now that the value of the incentive has been quantified and understood, and we are moving out of the evaluation period. We do not believe an annual incentive report should be required from year three onwards, and we would suggest instead that the incentive reporting is solely managed via the RRP process, as per the other incentives. There may also be changes required to Special Condition 4.7 of the RIIO-T2 Licences to implement Ofgem's decision, as well as to the associated Guidance Document.

The quality of engagement from the ESO has been strong on this incentive, and we are pleased overall with the way in which it is operating so far. We will provide a more detailed review of years one and two of the SO:TO Incentive, as part of the Final Incentive Report.

Question 4: Do you agree with our preferred option to use both the forecast and outturn constraint cost savings in the ODI reward calculation from year 3 of RIIO-2?

We recognise Ofgem's reasons for proposing that a blend of forecast and actual constraint cost savings could be used to calculate the incentive reward. We agree that it makes sense to apply a proportion of actual constraint costs, ensuring that TOs are not overly rewarded for solutions that are not ultimately required or delivered. However, the proposed 95:5 split between actual and forecast constraints may cause unintended consequences for the incentive, as set out in our response to Question 5 below.

Question 5: Do you agree with our preferred option to use a 95% weighting on the outturn constraint cost saving in the ODI reward calculation from year 3 of RIIO-2?

We recognise Ofgem's reasons for proposing that a blend of forecast and actual constraint cost savings could be used to calculate the incentive reward. We agree that it makes sense to apply a proportion of actual constraint costs, ensuring that TOs are not overly rewarded for solutions that are not ultimately required or delivered. However, the proposed 95:5 split between actual and forecast constraints may cause unintended consequences for the incentive.

The TOs make decisions regarding the time and resources to dedicate to identifying and developing potential optimisation schemes, based on the potential constraint cost benefit of the scheme. That decision making will be influenced by the shift towards using actual constraint cost values, as the TOs would not have confidence that schemes that they identify and make available to the ESO will be used, which could result in a minimal incentive reward despite potentially significant time and resources dedicated to development work on the scheme. Optimisation schemes that we deliver for the ESO may not necessarily be used, which would result in a very small incentive reward even though the scheme was in consumers' interests to be in place. There is a key risk that the change will lead to the TOs prioritising schemes that the ESO is more likely to use, at the expense of schemes that may have less certainty of being required but deliver very high consumer benefit. The proposal for a 95:5 weighting between actual and forecast constraint costs adds additional uncertainty to the operation of the incentive, and therefore weakens its strength in driving TOs to identify, develop and propose the full range of solutions it considers would provide system benefit. A stronger recognition of the forecast constraint costs in the incentive calculation would ensure that this issue is not realised. We therefore propose that a 50:50 weighting for the ex-ante and ex-post constraint cost savings would be more appropriate.

We believe that a 50:50 weighting provides greater consumer protection relative to the incentive trial period, whilst ensuring that the upfront certainty is available for TOs to develop schemes where they are agreed to be in consumers' interests, even if the ESO may not ultimately take the operational decision to use them. It is also not obvious that forecast constraint costs will always be greater than actual constraint costs, particularly given the increasing and unpredictable nature of constraint costs on the system. Whilst forecasts will always differ from actual constraint costs, we do not believe that the ESO systematically underestimates constraint costs in forecasts, but rather that wider system conditions in the 2021/22 year resulted in lower actual constraint cost savings than was forecast for the schemes.

Question 6: Do you agree with our preferred option to remove the annual financial cap on the ODI reward from year 3 of RIIO-2?

We strongly support Ofgem's consultation position to remove the cap and agree that this will support the delivery of more solutions and greater consumer benefit. Given that consumers receive c.90% of the constraint cost benefit from all optimisation schemes delivered, we share the view that this is a uniquely low risk incentive for consumers, with a very large upside. It is therefore appropriate that the incentive should be strong enough and wide enough in scope to incentivise as many solutions as possible to be developed and delivered.

We note Ofgem's consultation position not to remove the cap on rewards for year two of the trial incentive period. Whilst we recognise that this year is almost complete, solutions have been developed and delivered under the scheme that exceed the initial cap on incentive rewards in order to maximise consumer benefit. We believe it is fair that this benefit should be shared between consumers and the TOs, aligned with the principles of the RIIO framework, but under the strongly consumer-weighted 90:10 sharing factor. We remain in favour of the proposal to remove the cap on incentive reward for year two of the incentive.