TRANSMISSION INVESTMENT

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FAO: Anna Kulhavy

By email: anna.kulhavy@ofgem.gov.uk

13 March 2023

Dear Anna,

System Operator: Transmission Owner Optimisation Output Delivery Incentive

Transmission Investment (TI), as one of the UK's leading independent transmission companies, manages one of the largest offshore electricity transmission portfolios. TI also is developing two GB interconnector projects. We have successfully participated in the NG ESO Pathfinder programme, securing contracts to provide stability services at four sites in the two recent stability tenders and are a strong advocate of introducing competition into the delivery of transmission.

In that context, we are supportive of the proposal to continue and refine these incentive arrangements that encourage innovation and reward enhancements to transmission services based on the value to consumers, subject to the points made in this letter and attachment.

We encourage Ofgem to apply this policy consistently across all service capability enhancements

NG ESO has sought enhanced capability from OFTOs through a proposed change to the STC (CM085), which seeks to increase the voltage control capabilities available to the ESO, potentially beyond the proven technical envelope. As this is being pursued as a Code change, rather than incentivised through an enhancement of capability, OFTOs do not have the opportunity to share in the resultant consumer benefits. In addition, modification consultation responses suggest, there is a risk that OFTO incur higher costs from the increased duty on their plant and equipment.

While we support the use of the value-based (rather than cost) incentives to encourage innovation and delivery of enhanced capability from existing infrastructure, we would also encourage Ofgem to establish a level playing-field for all providers of transmission services.

Ofgem proposals introduce a risk of windfall gains, which is avoidable.

While removing the cap avoids limiting the incentive for the ETOs to bring forward enhanced service opportunities, it means the amount of the reward is only limited by the sharing factor. The analysis in the consultation shows that the ETOs earned rewards of around 55 times the value of their investment, a significant gain. The incentive aims to provide ETOs a 10% share of the consumer savings, however, actual rewards were around 15%, due to lower overall savings in constraint costs compared to the forecast, upon which rewards are calculated.

If this situation is reversed, and actual savings are larger than forecast, it would result in a further windfall gain where there is no cap. In the current energy context, where oil and gas companies are criticised for earning excessive profits from high market prices, allowing an unlimited reward may appear unjustified.

We would strongly advocate retaining a capping mechanism using a cap and floor style approach. To avoid limiting the incentive, the cap could be set, and updated, as a proportion of the sum of the forecast constraint savings across all the accepted enhancements. This would be combined with the consultation proposal of a ‘floor’ reward based on 5% of forecast savings, to protect the ETO suffering a material loss.

In this approach, depending on the amount of actual constraint savings, the ETO would earn a minimum of 5% and maximum of 10% of the forecast savings. The strength of the incentive could be adjusted by changing the cap or floor percentages, either overall by increasing the maximum share for the ETO, or for individual enhancements contributions into the overall cap/floor.

Marrying this with the reward based on part forecast, part outturn savings would share the forecast risk between consumers and ETO. It would avoid the risk of windfall gain, while also providing overall headroom for ETOs to earn benefits above 10% for the most successful actions, where other actions fall short of expectations.

We hope the contents of the letter and the attachment are helpful and we would be pleased to discuss any points raised.

Yours faithfully,

Mark Fitch
Corporate Development and Regulation Manager

ATTACHMENT – responses to the specific consultation questions

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

Yes.

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?

Yes.

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?

Yes.

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?

Yes, but subject to the retention of a capping mechanism to avoid windfall gains.

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?

The proportion (5%) of forecast constraint savings sets the 'floor' reward, to avoid the ETO incurring losses. The results would suggest that this is generous in regard to covering the costs of delivering these enhance capabilities, however, if combined with a cap appears to be a reasoned trade-off to provide a good incentive for continuing participation in the process.

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?

No. We strongly disagree with the removal of the cap.

The removal of the financial cap, combined with the move to largely outturn based rewards creates the risk of windfall gains, where constraint savings are larger than forecast. Where the ETO are being protected from losses by a generous floor reward, this should be balanced with a suitable cap on rewards.

It should be noted that the ETO have no financial incentive to avoid constraints on the system and allowing unlimited reward may increase the potential for gaming around these enhancements.