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**13 September 2016**

Dear David,

This response was prepared by Citizens Advice. Citizens Advice has statutory responsibilities to represent the interests of energy consumers in Great Britain and welcomes the opportunity to respond to this consultation on changes to electricity System Operator (SO) incentives. Our main concerns in relation to this consultation are the escalating costs and difficult procurement environment for black start services, which are discussed in question 4.

*1a: Should we place financial incentives on the SO in the period between 1 April 2017 and when we are in a position to implement longer term SO incentives?*

*1b: If we maintain financial incentives from April 2017 to spring/summer 2018, should we use the existing BSIS framework?*

*1c: Do you agree that if we maintain the existing incentives framework during this period, we should seek improvements from the 2015-17 scheme?*

Citizens Advice broadly supports the current system of SO incentives, and is happy with the proposals to operate an incentive programme from April 2017 until the conclusion of the fundamental SO review.

**Patron HRH The Princess Royal**

**Chief Executive Gillian Guy**

Citizens Advice is an operating name of the National Association of Citizens Advice Bureaux

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*Question 3a: How could the BSIS target setting approach and modelling methodologies be improved in the short term?*

*Question 3b: Do you believe the existing BSIS sharing factor and cap and floor remain appropriate?*

The BSIS plays an important role in putting pressure on the costs of the electricity system operations. We support the principles behind it and are supportive of its continued operation.

In regard to the issues raised by this consultation for future consideration, we have only one question: what evidence does Ofgem have the the BSIS sharing factor and cap reward the SO with the amount of money required to get them to change their behaviour, but no more than that? The consultation document provides no information that could be used to assess this. If in future you will be considering “whether £30m and 30% would remain appropriate and ... welcome stakeholder views on this,” it would be good to see analysis showing the marginal effects of this incentives (and indeed others with revenue sharing/cap-and-collar arrangements). Is there any way of knowing whether £25m or 40% sharing would have different effects on National Grid’s behavior from the numbers chosen? If there is any way for Ofgem to expand its evidence base before the SO review and the next round of RIIO proposals it would be valuable for getting the most informed degree of stakeholder feedback.

*Question 4: What is the best way to set an incentive on the SO to incur efficient costs when procuring Black Start from April 2017?*

The environment for procuring Black Start services has become increasingly challenging in the last year. The closure of some coal-fired power stations, and the precarious economics of several others, has depleted the pool of potential suppliers while driving up the bargaining power of those which remain. The limited number of viable providers of Black Start services, combined with the appearance of National Grid as a distressed bidder, make this an area at serious risk of being unable to provide value for money.

Citizens Advice has been concerned by some of the contracts signed to provide Black Start services. With no visibility of the relative prices of potential bidders to provide black start services, it is difficult for external parties to judge whether National Grid's contracting in this regard has achieved. The request for a considerable increase in the value of the Black Start incentive to £150m shows that this programme could be taking on much greater significance in coming years, exacerbated by the poor economics of coal-fired generation.

Underpinning this figure is a value of Lost Load estimation that is [higher than international comparators and previous values used in GB](#) at £17k/MWh, with a figure of £68k/MWh beyond the fourth hour of interruption. They exceed the range of £3-6k/MWh used in setting cash out policy. Estimates of VoLL will be necessarily crude, as it is impossible and undesirable to test the responses of different groups of consumers at different times of year. We accept that any number is going to be somewhat arbitrary as a result. However, the discrepancy between the numbers presented by National Grid here and numbers used in other areas of security of supply policy is too large to be justified under the evidence supplied in this consultation and (more relevantly) in the Income Adjusting Event proposals.

The [study from which these estimates are drawn](#) found wide variation in its estimates for VoLL depending on survey methodology and consumer group. A study of willingness to pay estimated a far lower value than one covering willingness to accept, while household consumers showed a lower VoLL than commercial ones. We are concerned that putting too great an emphasis on the high-end estimates from the study overstates the value of VoLL, and by extension, of black start services to prevent lost load. As a result we encourage Ofgem to respond to National Grid's request using more conservative estimates of VoLL.

If the market for Black Start services is approaching monopoly conditions, with a shrinking pool of suppliers and no surplus providers to be able to draw on who can provide competitive pressure, a fundamental change in approach may be needed. In an era when costs were much smaller, a behind the scenes negotiation between National Grid and power station owners was

maybe understandable. But as costs have become more material, more transparency is needed. If the pool of eligible providers needs to be expanded via retrofits to existing power stations (by no means a given, but strongly suggested by National Grid's Black Start literature) this should be carried out in an open way that maximises the number of offers.

Any move to ex post assessment of National Grid's Black Start spend should include an assessment of how well National Grid has expanded the pool of potential suppliers as widely as possible, and the extent to which it has been able to source genuine competition for provision of the service.

*Question 5a: Do you agree that we shouldn't maintain the MDLC?*

*Question 5b: Do you agree that we shouldn't maintain the SO IRM? Are there any alternative ways to encourage innovative behaviour from the SO in the short term?*

Citizens Advice agrees with the reasoning behind closing these incentives.

*Question 6a: Do you believe there is a need for a new incentive on short term demand forecasts from April 2017? How could this be designed? What timescales should it be based on: week ahead, day-ahead, hour-ahead, other?*

*Question 6b: Do you think there needs to be any changes to the wind generation forecasting incentive or new incentives on any other system forecasts?*

Citizens Advice has no evidence on wind forecasting methodology. We agree that there could be efficiency gains from better forecasting and response to embedded generation.

*Question 7: Do you think the SO's procurement of balancing services needs to be more transparent and open? If so, what steps should be taken? Should the SO pursue more market-based approaches? Should we introduce any incentives or requirements on the SO in this area from April 2017?*

We would support the introduction of much greater transparency and visibility over the terms of ancillary services procured by the SO and greater information about the extent of competition to provide those services. While we recognise there may be some limits due to commercial sensitivities, we

would hope to see much greater evidence that the SO had attempted to source services from a variety of possible providers, and that it had opted for the most cost effective options.

*Question 8: Do you agree with our proposed scope of changes? Is there anything else you believe should be changed, added or removed from the existing scheme?*

Citizens Advice has no further suggestions for changing the existing incentive scheme.

Citizens Advice welcomes the prospect of a fundamental review of the SO role, and looks forward to contributing to those discussions in the months to come. Questions about potentially major changes to the role of the SO and its relationship to National Grid's TO operations will continue to create uncertainty for the industry with consequential costs for consumers if capital costs increase, and the potential for delays to system upgrades until a clear decision is reached.

Yours sincerely,

Simon Moore

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