Security and Reliability Council

Enhancing the system operator performance assessment cycle

a Secretariat report to the SRC

2 December 2011

Note: This paper has been prepared for the purpose of the SRC discussion. Content should not be interpreted as representing the views or policy of the Electricity Authority.

Contents

1 Recommendations

1.1.1 It is recommended that the Security and Reliability Council:

a) **discuss** possible initiatives aimed at enhancing the current arrangements for system operator performance assessment, including those set out in Section 6 of this report;

b) **develop** a set of proposed enhancements for recommending to the Electricity Authority for its consideration and discussion with the system operator;

c) **develop** a preliminary set of performance measures for recommending to the Electricity Authority as input to its discussions with the system operator; and

d) **agree** the process for finalising and making its recommendations to the Board.

2 Rationale

2.1.1 The Security and Reliability Council (SRC) is appointed, in accordance with the Electricity Industry Act 2010 (Act), to provide independent advice to the Electricity Authority (Authority) on, inter alia, the performance of the system operator. The Authority assesses the system operator's performance under both the Electricity Industry Participation Code (Code) and the System Operator Service Provider Agreement (SOSPA).

2.1.2 The Authority in particular, and stakeholders more generally, are seeking an improved system operator performance assessment process that recognises the wider role of the system operator and provides a comprehensive and cohesive set of performance standards against which it is formally assessed.

2.1.3 Furthermore, the system operator wrote to the SRC in April 2011 setting out a number of issues with the current performance assessment arrangements, in particular a concern that its performance is regularly assessed under three different mechanisms – the Code, the SOSPA and the compliance regime – and that more consistent performance incentives would be provided by a more focussed approach to assessment. The Authority intends responding to the concerns raised as part of this work.

2.1.4 As Regulator and Service Provider respectively, it is appropriate that any new arrangements, including any formal performance standards, be developed and agreed between the Authority and the system operator. However, as input to this process, and in recognition of the SRC's role and its members' expertise, the Authority is seeking early SRC input to this process. The Authority also notes that this work is related to the "dashboard" initiative that the SRC has been developing in liaison with the system operator. Accordingly, the Authority invites the SRC to provide advice on possible enhancements to the system operator performance assessment process, including in particular, input on appropriate performance standards.

2.1.5 The Secretariat has prepared a set of possible initiatives, drawing on the Authority's experience with the assessment cycle over recent years and the issues raised by the system operator. The Secretariat has also compiled a set of implicit performance reporting measures drawn from recent system operator performance assessment documentation (Appendix A). The SRC is invited to discuss possible enhancements to the system operator performance assessment arrangements, drawing on the material presented here, then develop a set of SRC recommendations to the Board.

3 Next steps

3.1.1 The SRC is asked to agree a process for finalising and making its recommendations to the Board. It is envisaged that the SRC will make its recommendations to the Board early in the New Year, although this depends on the outcome of the SRC discussion at this meeting and the process adopted for finalising its recommendations.

3.1.2 The Board will then consider the SRC's recommendations and engage with the system operator regarding possible initiatives and performance standards.

3.1.3 The next performance cycle under the Code begins on 1 September 2012, and it is intended that any new arrangements be in place by then. If the SRC's recommendations also have implications for the Board's engagement with the system operator under the SOSPA contract (refer section beginning at para 4.2.15 below), then these may need to be in place before the new financial year begins on 1 July 2012.

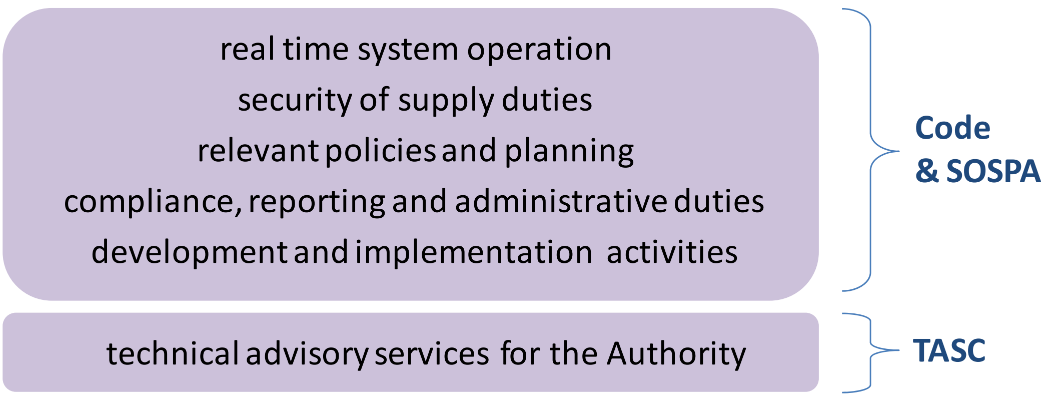
4 Introduction and background

4.1 System operator role

4.1.1 The system operator service provider function is prescribed under the Code, and in the SOSPA contract between the Authority and Transpower. The Act prescribes that Transpower is the system operator, thus the role is non-contestable.

4.1.2 For the purposes of this discussion, it is useful to consider the role of the system operator as having the key aspects depicted in Figure 1. The first five are covered by the Code and the SOSPA in combination, and the sixth is addressed in a recently established "Technical Advisory Services Agreement" (TASC). The TASC was designed and negotiated between the Electricity Commission (Commission) and system operator in recognition of the fact that aspects of the system operator's services required by the Commission took the form of consulting and development activities for the Commission's own work programme. The Authority is now the counterparty to the TASC, which documents the basis on which the Authority contracts with the system operator for specific services.

Figure 1: Key aspects of the system operator role



4.1.3 The system operator receives a base fee more than $34m pa for the Code and SOSPA services it provides, and this is funded from the levy on participants. There are other fee components under

SOSPA to cover certain itemised matters. TASC payments are based on a fee for service arrangement.

4.1.4 In addition to the financial impact on participants by virtue of the levy, the manner by which the system operator fulfils its duties under the Code and the SOSPA has material and direct financial implications for all market participants in their day to day electricity-related activities (and, more generally, for a wider stakeholder group including consumers). In particular, system operator activities impact on market prices, ancillary service costs, the operating and investment activities of market participants and transaction costs amongst other things. By way of example, the system operator procured annual ancillary services totalling more than $78 M in 2009/10, and these costs are passed on in full to market participants, and ultimately paid for by consumers.

4.1.5 Thus, as the regulatory body and counterparty to the SOSPA contract, assessing the performance of the system operator is a very important aspect of the Authority's role.

4.2 Regulatory and contractual framework

4.2.1 The Code and the SOSPA provide the regulatory and contractual framework for system operator performance assessment.

The Code

4.2.2 Part 3 of the Code sets out a number of provisions relating to market service providers generally, including the system operator. Although the Part 3 provisions relating to monthly self-review and reporting apply to all service providers, the Part 3 annual performance assessment provisions expressly exclude the system operator. These are instead co-located with other system operator provisions and set out in Part 7 of the Code.

Monthly self-review and reporting

4.2.3 Clause 3.13 of the Code requires the system operator to undertake a monthly self-review of performance focussing on compliance with:

a) obligations under the Code;

b) operation of the Code and the Act;

c) any performance standards agreed between the system operator and the Authority; and

d) the provisions of the system operator's service provider agreement with the Authority.

4.2.4 Under Clause 3.14 the system operator must provide a monthly report to the Authority on the results of the self-review, including any failure to comply with the Code/Act, events that might highlight the need for Code changes, and any other matter the Authority requests.

Annual performance assessment

4.2.5 Under Clause 7.11 of the Code, the System Operator is required to provide to the Authority by 30 September, a review and assessment of its own performance for the previous 12 month period ending 31 August. The Authority is required to publish this self-assessment on its website.

4.2.6 The timing of this performance period is based on the annual system operator Policy Statement cycle in the Code. The Policy Statement sets out policies and means that are considered appropriate during its term (1 September to 31 August) for the system operator to observe in complying with the principal performance obligations (PPOs) set out in the Code. These relate to common quality and system operation. The Policy Statement is reviewed annually and approved by the Authority[1].

4.2.7 Clauses 7.8 and 7.9 of the Code outline the requirement for the Authority to perform a review of the system operator's performance and the matters that the Authority must consider in its review. Clause 7.8 requires the Authority to concentrate on the System Operator's compliance with certain matters, which by design are the same matters as the monthly system operator self-review reports (refer para 4.2.3 above).

4.2.8 Clause 7.9 requires the Authority to take into account the following matters when conducting the annual review:

a) the terms of the SOSPA;

b) the reports from the system operator to the Authority;

c) the performance of the system operator over time in relation to Part 7 (System operator) and Part 8 (common quality) of the Code;

d) the extent to which acts or omissions of other parties have impacted on the system operator's performance and the nature of the task being monitored;

e) reports or complaints from any person;

f) the fact that the real time co-ordination of the power system involves a number of complex judgments and inter-related incidents;

g) any disparity of information between the Authority and the system operator; and

h) any other matter the Authority considers relevant.

4.2.9 Clause 7.11(4) requires the Authority to publish its review and assessment of the System Operator within 10 business days of the meeting at which the Authority completes its review and assessment.

4.2.10 The provisions in the Code are an amalgamation of provisions from the previous regulatory regime (the Electricity Governance Regulations and Rules (EGRs)), drawn from:

a) regulations[2] relating to service providers generally, and the system operator specifically; and

b) rules relating to the system operator's performance of its Common Quality obligations (Part C of the EGRs).

4.2.11 The transition from the EGRs to the Code also saw the transfer of certain security of supply obligations onto the system operator. Because they are Code obligations, the system operator's performance assessment therefore now includes security of supply performance as well as the common quality and wholesale market obligations carried over from the previous regulatory regime.

4.2.12 In addition to the above, the Act provides for the establishment of the SRC, the function of which is to provide independent advice to the Authority on the performance of the electricity system

[1] The Policy Statement is incorporated by reference in the Code. The current version is available from the Authority's website at: http://www.ea.govt.nz/document/14932/download/act-code-regs/code-regs/the-code/

[2] The Electricity Governance Regulations and Rules 2004.

and the System Operator, and reliability of supply issues. As provided in the SRC's terms of reference , the Authority may seek its advice on, among other things:

> "the System Operator's performance including against its principal performance obligations, security of supply function and any other function of the System Operator important to the performance of the electricity system and/or to reliability of supply."

4.2.13 Accordingly, the regulatory framework provides for the SRC's advice to be taken into account in the review process, if and as requested by the Authority Board.

4.2.14 It should be noted that the system operator performance assessment regime is distinct from, and has a different purpose to, the Code's compliance regime which operates independently throughout the year investigating breach allegations and Code compliance matters. There are, however, linkages at the time of the annual performance assessment process, in particular:

a) the system operator self-assessment includes a section on system operator breaches over the reporting year;

b) the Authority Board seeks input from its Market Governance staff when compiling its system operator performance assessment report.

The SOSPA

4.2.15 The SOSPA sets out the contractual terms for the system operator's performance of its functions as a service provider under the Code. It also sets out the annual service fee arrangements. The system operator receives an annual base fee under the SOSPA of over $34m, plus additional fees to cover certain itemised matters (such as development activities, certain security of supply duties, audit costs etc).

4.2.16 When the SOSPA was renegotiated in 2009, the Commission, the governing body at that time, included an "at risk" component in the annual service fee. The Commission's impetus for this was the difficulty it had experienced with delivery in areas outside what the system operator perceived as its core business[3].

4.2.17 The purpose of the "at risk" component, as set out in the preface to the 2011/12 "at risk" documentation[4], is to:

a) incentivise acceptable performance from the system operator across all its contractual responsibilities, including the core functions and the areas the Authority wishes the system operator to particularly focus on when carrying out its duties under SOSPA;

b) define a standard for what constitutes good performance in those areas; and

c) incentivise system operator performance to that standard.

4.2.18 As per the SOSPA terms, the assessment criteria for the "at risk" component are set annually in advance by the Authority in consultation with the system operator. The "at risk" documentation also sets out other matters such as the assessment process and the weightings to be applied to each area. By way of example, the "at risk" component in the year to 30 June 2010 was based on its performance in two areas:

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[3] The TASC was also aimed at addressing these difficulties. The TASC has separate fee arrangements based on payment for agreed services and deliverables.

[4] Refer Appendix B.

- implementation of new capex and business planning arrangements (schedule 4 and clause 2.7 of the SOSPA); and
- service delivery (in general across the contract, and particularly in relation to provision of data and the additional services under clause 14 of the SOSPA).

4.2.19 The amount at risk each year ending 30 June is set at $250,000, which is less than 1% of the annual SOSPA base fee. This amount was considered an appropriate incentive to perform in the specified areas to the specified standard, while not introducing perverse incentives or unintended consequences for other aspects of system operator performance under the SOSPA or the Code.

4.2.20 The Authority assesses the system operator's performance in accordance with the "at risk" documentation shortly after the financial year is completed (30 June).

4.2.21 It is important to note that acceptable performance of the core system operator role is a mandatory requirement. In the event that the system operator's performance of its core role under the Code is inadequate, the Authority reserves the right to determine a zero "at risk" achievement.

4.3 Current arrangements

Code-based assessment process

4.3.1 The Authority's assessment process is largely based on that undertaken by its predecessor, the Commission. The Authority is now undertaking its second annual assessment of the system operator's performance under the Code (the first Authority assessment was for a transition year which began under the governance of the Commission and ended under the Authority).

4.3.2 The process is consistent with the requirements set out in the Code (refer previous section). Although the Code contemplates the Authority and system operator agreeing performance standards, no such standards have been formally agreed in advance with the system operator by either the Commission or the Authority[5]. The desire to address this is a key driver for the Authority in undertaking this work, and is a suggested focus for SRC input.

4.3.3 However, de facto performance reporting measures have emerged over time: the content and structure of the system operator's self-assessment report were developed by the Commission and the system operator when the EGRs were first implemented. These have been refined over time with experience and changing circumstance[6]. The current structure of the self-assessment report, in combination with that of the Board's assessment report, implies a set of performance reporting measures, though these are not listed explicitly nor are they necessarily a comprehensive and cohesive representation of all aspects of the current system operator role. Nevertheless, they have become a de facto set of performance reporting measures around which the annual assessment is structured.

4.3.4 To assist the SRC's discussion of the current arrangements and of possible enhancements, an implicit set of performance reporting measures has been compiled and is attached as Appendix A.

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[5] It is interesting to observe that, under the Code, agreed performance standards are optional for the system operator performance assessment process, but mandatory for all other market service providers.

[6] It should be noted that Authority staff are currently in discussions with the system operator regarding additional matters to be included in the monthly reports to better inform the monitoring and performance assessment process. An important example is enhancements to better capture trends in ancillary service procurement costs.

4.3.5 The current cycle in relation to performance assessment under the Code can be summarised as follows:

a) the performance assessment period begins 1 September each year when the new Policy Statement comes into force;

b) the system operator provides monthly reports throughout the year, consistent with monthly reporting requirements set out in the Code and the requirements established by the Authority[7];

c) Authority Staff and the System Operations Committee (SOC) of the Board consider the monthly reports throughout the year, engaging on matters that arise on an "as required" basis; The SOC Chair provides the Board with a brief SOC Report at the following Board meeting;

d) at the end of the performance year (31 August) the system operator prepares the self-assessment report required by the Code and submits this to the Authority by 30 September;

e) the Authority Board publishes the system operator's self-assessment in mid October, and invites stakeholders to provide feedback on it as input to the Authority's assessment process (although it does not undertake a formal consultation);

f) Authority staff compile feedback on the system operator's performance across the year, including material from the common quality, wholesale market, market performance and market governance teams who have direct contact with the system operator;

g) the Authority prepares a draft System Operator Performance Assessment Report (late October/November), drawing on:

  i) Authority staff feedback;

  ii) the views of the Board (including the Board's System Operations Committee);

  iii) regular monthly system operator reports provided during the year;

  iv) the system operator's self-assessment;

  v) any stakeholder feedback received;

  vi) the system operator's customer satisfaction survey results (if available, refer para 4.3.6); and

  vii) any other relevant material;

h) a draft of the Board's assessment is provided to the system operator for comment (mid to late November);

i) the Board finalises and publishes its report (December or January).

4.3.6 In recent years the system operator has conducted an annual customer satisfaction survey and provided the results to the Authority as input to the performance assessment process. Although this has provided useful information on the levels of satisfaction, it has not typically identified means to improve the measured satisfaction levels. The system operator has advised that this

[7] The system operator monthly reports contain information relating to the system operator's performance and also the performance of the system itself. Although the latter is not strictly required for system operator performance assessment, many stakeholders find the information useful and the system operator's continued provision of this should be encouraged.

year's survey is not yet complete, and that results will be forwarded to the Authority in December once they have been compiled.

SOSPA "at risk" component assessment

4.3.7 The Authority separately sets and reviews performance against the "at risk" component under the SOSPA in accordance with the process prescribed in the "at risk" documentation established prior to the financial year in question. The current cycle can be summarised as follows:

a) The "at risk" documentation is developed by the Authority in consultation with the system operator prior to the start of each financial year. It includes the following:

   i) the purpose, principles and assessment process for the "at risk" component;

   ii) the areas of focus for the financial year;

   iii) the weightings to be applied to each area; and

   iv) performance standards and measures for each area.

b) The assessment process includes informal quarterly sessions between the Authority and system operator to discuss how performance is tracking;

c) Shortly after the end of the financial year (30 June), Authority staff (particularly in the common quality and wholesale areas) co-ordinate recommendation of ratings for the Authority senior management to consider;

d) Outcomes (including explanations) are discussed with the system operator, before the "at risk" assessment is finalised.

e) The Authority senior management team considers system operator feedback and then finalises the determination of the "at risk" component. A detailed assessment is prepared and provided to the system operator, but is not published.

f) As required in the 'At risk" documentation, the Board publishes the overall rating and brief commentary as part of the annual review of the system operator's performance.

4.3.8 Attached for reference as Appendix A is an excerpt from the 2011/12 documentation, setting out the purpose, principles and assessment approach, together with an overview of the focus areas the Authority has set for 2011/12.

5 Issues with current arrangements

5.1 Introduction

5.1.1 This section highlights issues with the current framework and arrangements for system operator performance assessment that have been raised by the Authority and/or by system operator. It also includes preliminary Authority consideration of the issues. SRC members may wish to raise additional issues for consideration.

5.2 Multiple performance assessment processes

5.2.1 In its April 2011 paper to the SRC[8], the system operator set out its view that there are three different means of assessing system operator performance:

a) through the annual process of self-review followed by Authority review;

b) through the SOSPA "at-risk" component assessment; and

c) through the compliance framework.

5.2.2 The system operator views this as a "disjointed approach to assessment" and is concerned that:

a) "there is a risk that the system operator self-assessment, Authority assessment and at-risk component assessment will be at odds with each other, giving a confused picture of system operator performance to the Authority, SRC and participants"; and

b) "there is a potential for the system operator to be financially penalised under both the compliance regime and the at-risk portion of the SOSPA fee".

5.2.3 These are considered in turn.

5.2.4 Since 2009, the Commission and Authority have taken the view that it is appropriate to have a Code-based performance assessment framework operating in parallel with a SOSPA "at-risk" component assessment. The two assessments fulfil different roles and so need to use different processes. Experience has showed that the Code-based framework alone is not sufficient to incentivise system operator performance because it does not provide sufficient incentive for the system operator to address the Authority's concerns, in particular, in relation to development activities. On the other hand, the SOSPA-based framework would also not be sufficient on its own because it is not a public process, and because it does not cover a wide enough spectrum of issues.

5.2.5 While the Authority believes it appropriate to retain these two different performance frameworks, it agrees with the System Operator that it is important that the criteria and assessment approaches are consistent and complimentary with each other. The Authority has sought to ensure that the practice of implementing such approaches achieves such coherence.

5.2.6 It appears reasonable that the system operator is subject to both the compliance framework and a service-provider performance assessment framework. All other service providers are required to comply with the Code as well as participating in a regular performance assessment process. Nor does it seem problematic that the system operator could face financial penalties both under the compliance regime and the SOSPA at-risk component for the same incident (although the Authority is not aware of this situation having arisen to date).

5.3 Lack of formally agreed performance standards

5.3.1 Although de facto performance reporting measures provide the basis for the existing performance assessment, the Authority acknowledges that the lack of formally agreed performance standards is a weakness of the current regime, and this is discussed below. The system operator would like to see "a single set of agreed performance measures representative and appropriate to the

[8] A copy is available from the SRC's 27 April 2011 meeting page of the Authority's website http://www.ea.govt.nz/document/13762/download/our-work/advisory-working-groups/src/27Apr11/

system operator role", and is concerned that "the basis on which a performance assessment is to be conducted is not known in advance and is therefore not transparent".

5.3.2 Under the Code (rule 3.12), the Authority and each market operation service provider *excluding* the system operator "must, at the beginning of each financial year, seek to agree on a set of performance standards against which the market operation service provider's actual performance must be reported and measured at the end of the financial year". These provide a structured and robust framework for performance assessment. The Code does not contain any such obligation to develop performance standards for the system operator, but it does contemplate that such standards could be agreed – they are included in the list of matters that the Board must take into account (clause 7.8).

5.3.3 Neither the Authority, nor the Commission before it, has agreed a set of performance standards with the system operator to be used in its self-assessment and Authority assessment. This is not to say that no performance standards have been applied – the self-assessment and Authority assessment are each implicitly structured around a set of performance reporting measures that have emerged over time, arguably acting as de facto standards. The problem is that these implicit performance reporting measures:

- may not be complete (i.e. there may be important matters not adequately covered);
- are not necessarily expressed in an appropriate form for a performance standard;
- may not collectively deliver a cohesive set of performance standards;
- could potentially overlap or conflict with the "at risk" criteria under the SOSPA;
- are not formally agreed with the system operator in advance;
- are not formally documented.

5.3.4 The Authority considers that a comprehensive and cohesive set of system operator performance standards should be developed and implemented as a matter of priority. It regards SRC input as an important aspect of the development process.

5.3.5 With regard to the Code-based process, the system operator's concerns (as set out in the April 2011 paper to the SRC) appear reasonable. All performance assessment frameworks need to include clearly specified assessment criteria in order to be effective. Some issues that should be taken into consideration in developing the new standards are that:

a) they should address the matters set out in para 5.3.3 above;

b) they should include standards relating to performance against the system operator's new Security of Supply obligations;

c) they should be consistent with the SOSPA "at-risk" criteria where relevant; and

d) they should be reasonably constant from year to year (otherwise, as the system operator notes, "there is a limited ability to improve performance in key areas over time as the measurement aspects from year to year may vary significantly").

5.3.6 The system operator suggested five broad areas on which performance measures could be based:

- compliance including PPOs
- operational event management

- ancillary services and contractual management
- business planning and management
- stakeholder satisfaction

5.3.7 The Authority is already comfortable with the level of agreement and documentation of performance standards for the SOSPA “at-risk” component assessment. It notes that the “at risk” component is formally agreed in advance with the system operator.

5.4 Need for performance standards with greater clarity and objectivity

5.4.1 The system operator is concerned about the lack of “clear, measurable objectives and measures”, noting that “while there will always be an element of subjectivity in the assessment, such subjectivity should be kept to a minimum”. It is not clear whether this concern relates to the at-risk component criteria, the (implicit) Authority performance reporting measures, or both.

5.4.2 It is good for standards to be objective and quantitative where appropriate (the PPOs are a good example). However, there is a risk that mechanistic performance standards may:

a) be superficial (e.g. counting outputs rather than assessing the quality of those outputs);

b) fail to capture intangibles such as the quality of stakeholder relationships;

c) fail to provide enough flexibility to express all aspects of a particular performance issue; or

d) (in the worst case) lead to gaming – i.e. behaviour designed to score highly against the performance standard, without actually being what was wanted.

5.4.3 When developing performance standards for the Code-based performance framework, the Authority intends using objective, quantitative criteria where practicable (but giving heed to the risks listed above).

5.4.4 The same considerations will be taken into account when next the Authority sets the SOSPA “at-risk” assessment criteria.

5.5 Relative priority of performance aspects

5.5.1 The system operator is concerned about weightings that could be assigned implicitly and/or ex post to the different criteria, noting that “there is no mechanism to ensure all aspects of system operator performance are weighted correctly in relation to each other” and hence “limited aspects of performance can be considered areas of non-performance and can disproportionately affect the overall performance assessment”.

5.5.2 While the Authority acknowledges that the absence of prioritised performance standards can create the risk that an aspect of non-performance disproportionately affecting the overall result, it considers that the current arrangements for the Code-based review provide adequate checks and balances to mitigate this risk. It also notes that the “at risk” documentation explicitly assigns weightings to the areas of focus set out, but that the practical effect is relatively limited as the quantum at risk is less than 1% of the SOSPA base fee.

5.5.3 In developing a formal set of performance standards for the Code-based assessment, consideration could be given to ascribing weightings to each. The SRC is invited to provide input on the relative merits of such an approach.

5.6 Lack of formal process for stakeholder feedback

5.6.1 At this point, there is no formal process for participants to contribute to the Code-based system operator performance assessment. The system operator does not consult on its self-review and the Authority does not hold a formal consultation on its review (although it did informally seek participant comment on the system operator's self-review this year, and the review documents are published).

5.6.2 The Authority considers there may be merit in establishing a formal and transparent process for seeking participant feedback. This could be undertaken by the Authority or the system operator, and the results published.

5.7 Role of the SRC

5.7.1 The SRC is newly formed and there is a need to establish the most appropriate role and process for it meeting its Terms of Reference requirements in relation to providing advice on system operator performance. The Authority invites SRC comment on how it wishes to be involved in the regular monitoring process and in the performance assessment cycle.

5.7.2 It should be noted that the Board's System Operations Committee also engages regularly with the system operator throughout the year. This has typically provided the forum for receiving and reviewing monthly system operator reports, and engaging on matters contained within them in the first instance. The responsibilities of the System Operations Committee include:

a) overseeing the performance monitoring of the system operator;

b) identification of any emerging system security risks; and

c) discuss any other matters relating to the system operator's obligations under parts 3, 7, 8, 9, and 13 of the Code.

5.8 Mid year feedback

5.8.1 The system operator comments that "there is little opportunity or basis throughout the year to discuss performance and performance issues meaning there is little opportunity provided to respond or improve".

5.8.2 While there is no formal mechanism for within-year interaction on performance measures, the Authority and system operator engage at a variety of levels on an almost daily basis. It has been found in the past that such regular engagement has provided opportunities for both parties to discuss performance issues during the course of the year, and that the system operator has generally been responsive to any issues raised by the Authority.

5.8.3 The System Operations Committee engages with the system operator every two months and formally reviews the system operator's monthly performance reports.

5.8.4 Authority staff meet formally once per month to discuss system and management issues which includes discussion of any performance issues.

5.8.5 However, it may be helpful to build more frequent discussions into the formal performance framework as per the system operator's suggestion.

5.8.6 The system operator and the Authority are trying to evolve the framework for these interactions e.g. keeping separate the joint work planning (JWP) and management meetings, evolving the JWP processes, separate quarterly capex reviews etc, and that these processes are continually being refined.

5.8.7 It is worth noting that the SOSPA “at risk” assessment process includes quarterly informal sessions to review performance and provide feedback.

5.9 Code requirements

5.9.1 As a result of the various regulatory changes to the Code and its predecessors over the years, the provisions relating to system operator performance assessment are spread across different sections of the Code, and contain some apparently overlapping requirements. Legal advice is that the various requirements are not internally inconsistent and can be met simultaneously (as has been the practice), but that streamlining would be advisable at some point for ease of reference.

5.9.2 More significantly, as a result of changes in the Code and in the system operator role over time, the performance assessment provisions may now not be:

a) complete (ie reflect all aspects of the system operator’s role, including the newly added security of supply obligations);

b) cohesive (ie collectively deliver a consistent and streamlined assessment process).

5.9.3 Accordingly, as part of implementing a package of enhancements, consideration could be given to reviewing the existing Code provisions for completeness and consistency. It might also be appropriate to consider codifying some aspects of any new arrangements going forwards, where certainty and enforcement via the compliance regime are desirable.

6 A package of possible enhancements for SRC consideration

6.1.1 A package of possible enhancements has been developed as a starting point for SRC discussion, drawing on the issues presented in the previous section. The SRC is invited to consider the following suggestions, and make its own amendments, with a view to the SRC making a formal recommendation to the Board early in the New Year.

6.1.2 The SRC is also invited to develop a preliminary set of performance standards for recommending to the Authority as input to its discussions with the system operator on enhancing the current performance assessment arrangements. Implicit performance reporting measures drawn from recent system operator assessment documentation is included as Appendix A as background to the SRC’s discussion.

Performance standards

a) The Authority and system operator should jointly develop and agree a comprehensive and cohesive set of system operator performance standards to apply for the next performance year starting 1 September 2012;

b) The performance standards should be designed to provide a more structured and objective approach to performance assessment, with an emphasis on quantitative standards to the extent practicable (while avoiding being excessively mechanistic);

c) The performance standards should be designed to sit alongside, and be coherent with, any “at risk” criteria set by the Authority Board under the SOSPA;

d) The performance standards should cover the system operator’s new security of supply obligations;

e) An attempt should be made to develop enduring standards that will not need to be changed substantially from year to year;

f) Performance standards should be agreed before the last quarter of the current (2011/12) assessment year, in order to allow three months of reporting against these standards on a trial basis;

Monitoring

g) The Authority should ask the system operator to review its monthly reports to ensure that they provide the information the Authority Board, staff and participants seek, and reflect the newly agreed performance standards;

h) The Authority should undertake a half-yearly informal review of the system operator's performance in order to provide feedback and an opportunity for addressing any issues identified;

i) The Authority should consider the roles of the SRC and the Board's System Operations Committee in the performance assessment process;

Self-assessment

j) The requirement for the system operator to provide its own annual self-assessment should be retained;

k) The Authority should ask the system operator to review the content of that document to ensure that it provides the information the Board seeks and reflects the newly agreed performance standards;

Stakeholder feedback

l) As input to its Annual Review of the system operator, the Authority should formally seek feedback from key stakeholders (or require the system operator to seek and publish feedback);

Code amendments

m) The Authority should consider reviewing the existing Code provisions for completeness and consistency;

n) The Authority might wish to take this opportunity to codify some aspects of the revised performance management process.

Appendix A Implicit performance reporting measures

Although neither the Authority nor the Commission before it has agreed formal performance standards with the system operator, an implicit set of performance reporting measures can be inferred from historical system operator performance reports. Arguably these have become de facto standards, although they have not been formally agreed as such. The following have been compiled from the Code-based system operator performance process – they feature in the system operator's self-report or the Authority Board performance report or both, and relate to system operator performance as distinct from system performance. Possible security of supply performance measures have been included for completeness.

Business as usual

- Meeting PPOs
- Meeting dispatch objective
- Successful operational management of actual system events
- Successful operational management of potential system risks
- Market systems uptime
- Quality and timeliness of system operator involvement in commissioning of assets

Compliance

- Number and nature of system operator breaches
- Compliance with reporting obligations
  (monthly reporting, SSF, Policy Statement, Procurement Plan, audits of SPD and RMT)
- quality of changes to Policy Statement and Procurement Plan

Working with the Authority

- Positive and constructive relationship
- Engagement with EA in process of developing Joint Work Plan, Business Plan and Capex Plan
- Performance vs. Joint Work Plan
  (note: there is a particular focus on (a) contribution to market design work at design and implementation stages, and (b) quality of investigations)
- Compliance with obligations under SOSPA
  (eg review of Disaster Recovery Plan, review of system operator auditable software and audit process
- Performance with respect to the SOSPA at-risk criteria

Working with industry

- Positive and constructive relationship
  (note: this would include the system operator's participant satisfaction survey if available)

Systems improvements

- Performance vs Capex Plan
  (note: there is a particular focus on the quality and timeliness of market systems improvements)

Security of supply

- Improvements to security of supply policies and plans
- Quality and timeliness of publication of Security of Supply information
- Performance during any extended emergencies (if applicable)

Appendix B SOSPA "at risk" component documentation

Application of SOSPA "At Risk component": 2011/12 Period

	Description	Comments / proposal
1.	**Purpose** of "at Risk" component	The purpose of the "at risk" component in the SOSPA is to: • Incentivise acceptable performance from the System Operator across all its contractual responsibilities including the core functions and the areas the Authority wishes the System Operator to particularly focus on when carrying out its duties under SOSPA over the following 12 month period; • Define a standard for what constitutes good performance in those areas; and • Incentivise System Operator performance to that standard.
2.	**Principles** for the "At Risk" component, consistent with purpose	• Should be relevant, clear, measurable, and consistent with the quantum of the at risk component; • Development process should involve the System Operator; • Areas of focus likely to be varied from year to year; • Gaining 100% should be seen as attainable, rather than a stretch target only for outstanding performance beyond the call of duty; • Gaining 100% is predicated on the core functions being carried out to the standard of a reasonable and prudent System Operator. • Should aid, not distort, incentives on performance across the entire contract; and • Should not be inconsistent with performance standards/KPIs established for the annual System Operator Performance Review process, nor deliver materially inconsistent outcomes.
3.	**Approach to assessment**	• Establish percentage of at risk component attached to each objective. • Develop performance standards for each objective: • a mixture of outcome and process-based descriptions (i.e. what & how), tailored to focus area and performance standard sought. • Establish percentage weighting for each performance standard for each objective. • Hold informal quarterly sessions between the Authority and System Operator to discuss how performance is tracking. • Following year end, Authority staff (particularly common quality/wholesale) co-ordinate recommendation of ratings to the Authority CEO. Outcomes (including explanations) will be discussed with the System Operator, before the outcome is finalised. • Publish overall rating and brief commentary as part of the annual review of the System Operator's performance.

At Risk Arrangements – 2011/12

B.1.1 Focus of "at risk" component in 2011/12 year is on maintaining the joint planning arrangements specified in the Guideline, service delivery and project deliverables, in particular the following areas:

a) Part 7 of Code joint planning requirements including capex and business planning (SOSPA schedule 4 and clause 2.7, respectively);

b) Service delivery (in general across the contract, and particularly in relation to provision of data and the additional services under clause 14 of the SOSPA); and

c) Meeting agreed project deliverables for selected items on the Joint Development Programme.

B.1.2 Acceptable performance of the core System Operator role is a mandatory requirement. In the event that the System Operator's performance of its core role under the Code is inadequate, the Authority reserves the right to determine a zero "at risk" achievement.