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Date: 14 December 2022

Dear Stakeholders,

Distribution System Operation Governance Document Consultation Response and Statutory Consultation

This letter¹ sets out our² response to our consultation on the RIIO-ED2 Distribution System Operation ("DSO") Incentive Governance Document ("the Consultation").³

This letter explains our proposals and the changes we have made to the DSO Incentive Governance Document in response to the views stakeholders shared with us through the Consultation.

Background

In November 2022, we consulted on the DSO Incentive Governance Document which set out the processes and requirements involved in the DSO incentive that was proposed in our RIIO-ED2 Draft Determinations⁴. We have now published our RIIO-ED2 Final Determinations⁵ and our intention is for the DSO Incentive Governance Document to come into effect at the start of RIIO-ED2.

¹ Alongside this letter we are publishing a "track change" and "clean" version of the DSO Incentive Governance Document to allow parties to review the changes made since the Consultation.

² References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

³ [RIIO-ED2 DSO Incentive Governance Document Consultation | Ofgem](#)

⁴ [RIIO-ED2 Draft Determinations | Ofgem](#)

⁵ [RIIO-ED2 Final Determinations | Ofgem](#)

The DSO Incentive Governance Document describes the processes and criteria used to assess performance, the reporting requirements, and the methodology we will use to determine an incentive reward or penalty.

Stakeholder responses

We received 12 responses to the Consultation, and we will be publishing non-confidential responses on our website in due course.

Overall, the responses were broadly supportive of our proposed document. Stakeholders provided helpful clarifications on definitions, the DSO Stakeholder Survey⁶ approach, and DSO Performance Panel assessment processes and scoring guidance, which we have enacted.

Some stakeholder responses related to broader policy intent and therefore we considered these in our Final Determinations. The rationale for our final decisions on the following can be found in paragraphs 4.47 – 4.79 of the RIIO-ED2 Final Determinations Core Methodology document:

- One Distribution Network Operator (“DNO”) proposed increasing the upside value of the incentive.
- Most DNOs proposed that greater weight should be placed on the Outturn Performance Metrics.
- One DNO suggested altering the DSO Stakeholder Survey target and deadband range.
- One DNO suggested changing the DSO Performance Panel deadband range.
- One DNO and two other stakeholders supported not implementing targets for the outturn performance metrics in Year 1 of RIIO-ED2. However, one DNO believed there was little evidence to suggest target setting was not yet appropriate, and another DNO would have preferred for targets to be set, even without the associated financial reward / penalty.

In the below table, we summarise broader issues set out in responses to the Consultation and provide our own view.

⁶ Please note that all defined terms within this letter have the meaning given to them in the glossary of the DSO Incentive Governance Document unless otherwise stated.

Issue	Comment
DSO Stakeholder Satisfaction Survey	
Some DNOs requested the introduction of minimum sample sizes / response rates for each question and a process for appealing scores.	We have updated the DSO Incentive Governance Document to clarify how DSO Stakeholder Satisfaction Survey scores will be determined in the event that responses fail to meet a minimum threshold.
One stakeholder recommended including an additional question that captured efforts around DSO standardisation.	We believe an element of this is captured in the existing questions, and that a specific question on standardisation could limit the scale of DNO innovation and/or would be better targeted at the sector as a whole.
DSO Performance Panel	
One stakeholder and one DNO proposed the DSO Performance Panel Submission should be pushed back to allow Regularly Reported Evidence ("RRE") and Outturn Performance Metrics to be included in the DSO Performance Panel assessment.	We maintain that there is benefit to running the DSO Performance Panel assessment as a discrete process, but would nonetheless expect DNOs to cross-reference relevant quantitative data as part of their DSO Performance Panel Submission.
One DNO opposed the call for evidence in the DSO Performance Panel assessment, suggesting that it would duplicate the DSO Stakeholder Satisfaction Survey. However, another stakeholder requested direct input into the DSO Performance Panel sessions.	We believe the call for evidence strikes the right balance between sourcing stakeholder views to reduce information asymmetry and limiting the administrative burden of the DSO Performance Panel sessions.
One DNO proposed introducing a regional panel member or separate report submitted by a regional representative to highlight regional differences to the DSO Performance Panel.	We maintain our view that this would undermine the consistency in DSO Performance Panel scoring, and would argue that it is the DNO's responsibility to articulate regional differences within its DSO Performance Panel Submission.
Outturn Performance Metrics	
One DNO argued that RRE and Outturn Performance Metrics should be submitted in August to coincide with other reporting cycles and ensure adequate time for data assurance processes.	We consider that our proposed submission dates are consistent with RIIO-ED1 reporting timelines for Output Delivery Incentives.
One DNO proposed that the Curtailment Efficiency Outturn Performance Metric should be applied to customers connected only after 1 April 2023, as this would otherwise go against the Access SCR decision. ⁷ It also argued that additional funding and implementation time would be required if retrospective applications were enacted for existing connections.	We consider that our decision is in line the with Access SCR, as the final decision is such that customers should have the right to renegotiate on new terms at any time subject to the relevant ongoing DCUSA modification proposals being made. We also believe that DNOs were provided with adequate allowances in the RIIO-ED2 Final Determinations. ⁸
Other	

⁷ [Access and Forward-Looking Charges Significant Code Review: Decision and Direction | Ofgem](#)

⁸ See RIIO-ED2 Final Determinations Overview document, Chapter 12, [RIIO-ED2 Final Determinations | Ofgem](#)

Issue	Comment
One DNO strongly disagreed with performance ranking within the DSO Incentive Report, while another stakeholder supported this and suggested holding an open session following the publication of the DSO Incentive Report.	We believe ranking is necessary for the transparency of the DSO incentive and note that all DNOs will be held to account against common DSO Baseline expectations. However, we consider an open session would introduce a disproportionate administrative burden.
Some DNOs suggested changes / clarifications on the DSO Baseline expectations in Appendix 1.	We note that all DNOs submitted their Business Plans on this basis and we are not proposing any changes at this stage.

Finally, we consider that further issues and concerns raised in stakeholders' responses will be addressed in future publications including the Regulatory Instructions and Guidance ("RIGs") and a planned working paper on the DSO Performance Panel, as detailed in the Next Steps section below. These include:

- Detailed design of the DSO Stakeholder Satisfaction Survey script.
- Terms of reference for the DSO Performance Panel, including further information on membership and the management of conflict(s) of interest.
- Detailed reporting requirements for the Outturn Performance Metrics.

After considering the stakeholder feedback we received to the Consultation, we have updated the DSO Incentive Governance Document, which is published alongside this letter. The updated DSO Incentive Governance Document also reflects changes finalised in the Final Determinations, for which we considered responses to Draft Determinations.

Next steps

The DSO incentive within the RIIO-ED2 framework, including the DSO Incentive Governance Document, will come into effect from 1 April 2023.

Alongside the ongoing programme of work to implement the RIIO-ED2 framework, we will undertake the following activities to establish the DSO incentive:

- We will arrange a working group, proposed to be on 10 January 2023, to discuss any outstanding issues on the DSO Incentive Governance Document.
- Beyond that, we intend to:
 - Initiate the process, in early 2023, to gather data from the DNOs that will be used to inform Outturn Performance Metrics target setting.
 - Convene a series of working groups, in summer 2023, to discuss Outturn Performance Metrics target setting before we consult on the proposed targets

with a view to implementing these from Year 2 of RIIO-ED2 via the statutory modification process.

- Publish a working paper on the DSO Performance Panel, in summer 2023, to provide an update on the setup of the DSO Performance Panel and invite trade bodies / industry associations to nominate voluntary representatives to be part of the DSO Performance Panel.

We greatly appreciate the input stakeholders have contributed to the RIIO-ED2 design process. If you have any feedback on performance under the DSO Incentive, including both positive examples and areas of concern, you can share views with us directly or arrange a time to discuss your views with us by sending an email to flexibility@ofgem.gov.uk.

If you have any questions on the contents of this letter, please contact us at the email address above.

Yours faithfully,

Mike Duncan

Head of Policy, DSO Regulation

Energy Systems Management & Security