

Electricity Distribution Network  
Operators; and Stakeholders

Email: [RIIOED2@ofgem.gov.uk](mailto:RIIOED2@ofgem.gov.uk)

Date: 20 March 2025

Dear Company Secretaries and Stakeholders,

**Decision on proposal to modify the RIIO-ED2 Distribution System Operation ("DSO") Incentive Governance Document and Regulatory Instructions and Guidance ("RIGs") Annex I DSO**

On 17 January 2025, we published a consultation on proposed changes to the following documents for Electricity Distribution licensees:

- RIIO-ED2 DSO Incentive Governance Document
- RIIO-ED2 RIGs

**DSO Incentive Governance Document**

The DSO Incentive Governance Document is directed at electricity distribution network companies as well as at their stakeholders. The purpose of the document is to set out the processes and requirements involved in the DSO incentive. It defines the processes and criteria used to assess performance; sets out the reporting requirements; and the methodology we will use to determine an incentive reward or penalty.

**RIGs**

The RIGs are the principal means by which we collect cost, volume, allowed expenditure, obtain output delivery information from licensees to monitor performance against their RIIO-2 objectives. This information allows us to hold them to account.

## Reason for modifications

There were two key reasons for proposing changes to the RIIO-ED2 DSO Incentive Governance Document and RIIO-ED2 RIGs, which are as follows:

- 1) We introduced a new DSO incentive as part of the RIIO-ED2 price control for electricity distribution network operators (“DNOs”). It was originally intended that this would be made up of three parts: a stakeholder survey, performance panel assessment and three quantitative metrics. We announced our [RIIO-ED2 DSO incentive - decision on outturn performance metrics | Ofgem](#) in April 2024 to not proceed with the metrics due to concerns with data quality, a lack of historical data and methodological issues. The first year of the DSO incentive subsequently took place with only the survey and performance panel, and the publication of the [Distribution System Operation Incentive annual report - 2023 to 2024 | Ofgem](#) on 26 September 2024.
- 2) The first year of operating the DSO incentive has highlighted a number of areas where improvements could be made.

We proposed the following substantive modifications to the DSO Incentive Governance Document to implement these proposals.

- **Chapter 3:** new definitions to help with defining the survey process and calculation method for results; introducing process for managing responses which the DNO does not believe reflects a fair assessment of DSO activities in the relevant regulatory year; clarification that only one score per Organisation will be considered for the purposes of the survey results.
- **Chapter 4:** extending the length of the DSO Performance Panel Session from 40 to 60 minutes.
- **Chapter 5:** deleting this chapter to reflect our previous decision not to proceed with the DSO Outturn Performance Metrics as part of the incentive.
- **Appendix 4:** adding three new reporting requirements on flexibility, secondary network visibility and curtailment.
- **Appendix 5:** clarification that the DSO Performance Panel Sessions will be held in-person where possible.

We proposed the following modifications to the RIGs to implement these proposals.

- **Chapter 3:** deleting this chapter to reflect our previous decision not to proceed with the DSO Outturn Performance Metrics as part of the incentive.
- **Chapter 4:** adding three new reporting requirements on flexibility, secondary network visibility and curtailment.

We also proposed changes in both documents to reflect that the DSO incentive comprises the survey and performance panel assessment only. Furthermore, we proposed minor changes to improve the structure and clarity of the documents.

### **Consultation responses**

We received seven responses to our consultation; six from electricity distribution licence holders and one from an industry association. All respondents were supportive of the proposed changes.

Two respondents raised concerns about the proposal in the DSO Governance Document that would allow distribution network companies to may make five requests for removal per regulatory year of responses to the DSO stakeholder survey that they believe did not reflect a fair assessment of DSO activities. It was felt that an arbitrary cap of five responses could result in unintended consequences.

Six respondents also raised minor typographical issues in both the DSO Incentive Government Documents and in the RIGs and pointed out aspects of both that could benefit from greater clarity.

One respondent raised the issue of Active Network Management ("ANM") zones saying that they reduce revenue certainty for consumers and flexibility service providers, due to unpredictability and a lack of stackability for Distributed Energy Resources ("DERs") that are stuck behind them. It stated that that a pathway for retiring ANM should be pursued.

### **Our decision**

Following careful consideration of the responses, we have decided to implement the substantive modifications changes to the DSO Incentive Governance Document and the RIIO-ED2 RIGs that we had proposed in the consultation.

We agree with the suggestion by two respondents that the proposed cap of five requests for removal per regulatory year of responses to the DSO stakeholder survey could have unintended consequences. On reflection, we consider that a cap may mean that there could be a significant number of responses to the survey which do not constitute a fair assessment of DSO activities included in the relevant regulatory year. We considered an alternative, higher, absolute value for the cap or a percentage threshold but both options would still mean that there is potential for responses not relevant to DSO activity in the specific year being included in the assessment. We have therefore decided the optimal approach is to have no cap on the number of responses that can be removed but to only allow this subject to our approval and where:

- There is clear evidence that the response relates to a time period other than the relevant regulatory period; or
- It is clear that the basis for the response is related to activities that should not be considered DSO functions.

This is consistent with other incentives where a stakeholder survey is used (eg, Broad Measure of Customer Service) but will keep this under review.

We note concerns about the ANM zones. However, it is outside the scope of the DSO Incentive Governance work and therefore would need to be addressed through the preparatory work for RIIO-3

We have reviewed typographical and clarity issues that were raised in the DSO Incentive Government Documents and RIGs and have made amendments where it was appropriate to do so.

A copy of this letter will be published on our website.

The changes will come into effect on 1 April 2025.

Yours faithfully,

**David McCrone**

Head of Price Control Operations Policy

Duly authorised on behalf of the Authority

To:

**Electricity North West Ltd (ENWL)**

**Northern Powergrid (Northeast) Ltd (NPgN)**

**Northern Powergrid (Yorkshire) plc (NPgY)**

**National Grid Electricity Distribution (West Midlands) plc (WMID)**

**National Grid Electricity Distribution (East Midlands) plc (EMID)**

**National Grid Electricity Distribution (South Wales) plc (SWALES)**

**National Grid Electricity Distribution (South West) plc (SWESt)**

**London Power Networks plc (LPN)**

**South Eastern Power Networks plc (SPN)**

**Eastern Power Networks plc (EPN)**

**SP Distribution plc (SPD)**

**SP Manweb plc (SPMW)**

**Scottish Hydro Electric Power Distribution plc (SSEH)**

**Southern Electric Power Distribution plc (SSES)**

(each one a "Licensee", and together, "the Licensees")

**Decision under Part F of the Special Licence Condition 4.8 (Distribution System Operation output delivery incentive) ("SpC 4.8") and Part C of the Standard Licence Condition 46 (Regulatory Instructions and Guidance) ("SLC 46") of the Electricity Distribution Licence (the "Licence") granted under section 6(1)(c) of the Electricity Act 1989 (the "Act")**

**Decision to modify the RIIO-ED2 Distribution System Operation (DSO) Incentive Governance Document and Regulatory Instructions and Guidance ("RIGs") Annex I DSO**

1. The Authority is issuing its decision to modify the RIIO-ED2 Distribution System Operation ("DSO") Incentive Governance Document under SpC 4.8 and the Regulatory Instructions and Guidance ("RIGs") Annex I DSO under SLC 46 of the Licence.
2. The DSO Incentive Governance Document sets out the processes and requirements involved in the RIIO-ED2 DSO incentive. It defines the processes and criteria used to assess performance; sets out the reporting requirements; and the methodology the Authority will use to determine an incentive reward or penalty.
3. The RIGs are the primary means by which the Authority directs the Licensees to collect and provide information to the Authority, to enable it to administer the

Special Conditions of the Licence and, where not referenced to in the Licence, the RIIO-ED2 Final Determinations.

4. We received seven responses to the consultation with proposed changes to the DSO Incentive Governance Document and to the RIGs, which we carefully considered. We have placed all non-confidential responses on our website. Our response to these comments is set out in our accompanying decision letter.
5. SpC 4.8 and SLC 46 set out the process for issuing and modifying the DSO Incentive Governance Document and the RIGs, respectively. In accordance with Part F of SpC 4.8 and Part C of SLC 46 and the notice given to the Licensees, the Authority hereby modifies the DSO Incentive Governance Document and the RIGs in the manner indicated in the documents that can be accessed on its website, published alongside this Decision Notice.
6. The reasons for, and effect of, the modifications is be to clarify and improve the operation of the DSO Incentive, as well as introducing new reporting requirements for the Licensees.
7. These modifications will take effect from 1 April 2025.

### **Further information**

8. The DSO Incentive Governance Document and the RIGs Annex I DSO published alongside this decision Notice show the modifications as incorporated.
9. Copies of this Decision Notice and other documents referred to in it are available on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).
- 10.** This document is notice of the reasons for the decision to modify the RIIO-ED2 Distribution System Operation (DSO) Incentive Governance Document and Regulatory Instructions and Guidance ("RIGs") Annex I DSO

### **David McCrone**

Head of Price Control Operations Policy

Duly authorised on behalf of the Authority