DNOs, IDNOs, consumer groups
and representatives and other
interested parties

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Consultation letter on the customer satisfaction survey incentive rate term in Part D of electricity distribution Special Licence Condition CRC8.

The purpose of this letter is to seek your views on the incentive rate term that will be used to reward or penalise Distribution Network Operators (DNOs) based on customers' satisfaction with their service. The customer satisfaction survey and the wider Distribution Price Control Review 5 (DPCR5) Broad Measure of Customer Satisfaction are due to be implemented on the 1 April 2012.

We would be grateful for your views on the following questions in particular:

- Do you agree with the high-level principles used to inform the Authority's "minded to" position? If not, why?

- Do you agree with the Authority's "minded to" position? If not, why?

- Are there any arguments in favour of one of the options that you think we have overlooked?

- Are there any other options that you think we should consider?

- Do you agree that the incentive rate term should be fixed for the remainder of DPCR5?

Background

Broad Measure of Customer Satisfaction

The Broad Measure of Customer Satisfaction is one of a suite of incentives introduced as part of the DPCR5. The incentive is designed to drive improvements in the quality of customer experience across a range of DNO services. The Broad Measure of Customer Satisfaction consists of three elements:

- customer satisfaction survey;
- complaints metric; and
- stakeholder engagement.

In this letter we are only consulting on the incentive rate that should be used for the customer satisfaction survey element of the Broad Measure.

Customer Satisfaction Survey

The customer satisfaction survey is designed to incentivise improved quality of service by capturing customers' experiences of the services delivered by a DNO licensee.

Each licensee is rewarded or penalised based on their performance against the industry mean in four components:

- supply interruptions;
- connections;
- general enquiries, and
- overall mean (calculated using the scores from the other three components)[1].

The maximum reward / penalty for each DNO licence equates to +0.8%/-0.5% of their base demand revenue in a given year, as specified in Appendix 2[2].

The Incentive Rate Term

Incentive Rate Term

The formula for calculating the incentive value of the customer satisfaction survey is set out at paragraph 8.34 in Part D of the electricity distribution Special Licence Condition CRC8[3]. The appropriate incentive rate term for the customer satisfaction survey has yet to be decided[4].

Final Proposals – Incentives and Obligations[5] specifies that the incentive rate term should be based on an "acceptable range of deviation from the industry mean that is revealed during a pilot survey"[6]. All licensees participated in a six month pilot of the customer satisfaction survey from May 2011 to October 2011. The results from this pilot are outlined on an anonymous basis in Appendix 3.

The licence stipulates that the Authority will issue a direction on an appropriate incentive rate term no later than 31 March 2012 following consultation with the licensees[3]. Our decision will be taken following consideration of responses to this consultation letter.

Approach taken to inform incentive rate term decision

Our interpretation of an acceptable incentive rate term is also informed by the following high-level principles that were discussed at the Customer Issues Working Group (CIWG)[7]:

- The incentive rate term must be based on a statistically recognised range of deviation.
- The percentage reward or penalty that each licensee receives must reflect performance.

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[1] The overall mean is weighted 40 per cent supply interruptions mean score, 40 per cent connections mean score and 20 per cent general enquiries mean score.
[2] The maximum revenue upside and down allowed revenue terms are specified in Table A9 and Table A10 of Electricity Distribution Special Licence Condition (SLC) CRC8.
[3] Special conditions of the Electricity Distribution Licence
http://epr.ofgem.gov.uk/document_fetch.php?documentid=15396
[4] In electricity distribution special licence condition CRC8, the incentive rate term relates to Vt for the overall mean componen*t*, Xt for supply interruptions component, *Yt* for the connections component and *Zt* for the general enquiries component. Final Proposals states that the incentive rate term will be based on range of deviation from the industry mean.
[5] http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf, 7 December 2009, 145/09.
[6] The approach to setting the incentive rate term will be fixed in the licence, the value of this term will calculated on an annual basis.
[7] The Consumer Issues Working Group (CIWG) is an Ofgem industry working group made up of Ofgem, DNOs and other relevant parties. It provides a forum to discuss policy issues relating to services provided by the DNOs to energy consumers in the UK.

- The incentive rate term must incentivise all licensees to improve performance.
- The incentive rate term must be capable of withstanding changes in industry performance.

Consultation

Options

There are a number of options available for setting an appropriate range of deviation. These options have been discussed with the DNOs as part of the CIWG. Five options are proposed as part of this consultation. These are:

1) The range between the maximum licensee score and the industry mean[8]
2) Standard Deviations
    a) One standard deviation from the industry mean
    b) 1.5 standard deviations from the industry mean
    c) 1.75 standard deviations from the industry mean
    d) Two standard deviations from the industry mean

Each option is set out in Appendix 1 along with our preliminary assessment against the high level principles. We welcome your comments on the options and on our initial views of each option.

To inform your comments, the percentage of each licensee's maximum reward or penalty that they would have received under each incentive rate option, based on the six month pilot, is highlighted on an anonymous basis in Appendix 4.

Other options considered

The option of adding a dead band around the mean (where the DNOs would receive no penalty or reward) was also discussed at the CIWG. The addition of a dead band is beyond the scope of our direction on the current definition of the incentive rate term and would require a more significant change to special licence condition CRC8. We do not think it is necessary to make this change, at this stage, as we are confident that that an appropriate incentive rate will be identified as a result of this consultation. It should be noted that the data collected for the last three years of DPCR5 will be used to inform policy for the next electricity distribution price control (RIIO-ED1).

Ofgem's "minded to" position

We consider that using a range based upon standard deviation provides a simple and statistically recognised method of identifying an acceptable range of deviation from the mean.

Having considered the results from the six-month pilot study alongside the principles discussed above, our "minded to" position is to set the incentive rate term at **1.75 standard deviations** from the industry mean, for all four components of the customer satisfaction survey. We consider that our "minded to" position is consistent with the original intentions of this incentive and our high-level principles:

- The incentive rate term must be based on a statistically recognised range of deviation.

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[8] This option was based on a proposal made by UK Power Networks that would use the range between the industry mean performance and the furthest outlying DNO as the incentive rate term. However, in *Final Proposals Incentive and Obligations* paragraph 13.6 we state that "the upper range will dictate what the annual incentive rate is". We have therefore modified UK Power Networks' proposal so that it takes into account the range between the highest scoring DNO and the industry mean performance.

- The percentage reward or penalty that each licensee receives must reflect performance.
- The incentive rate term must incentivise all licensees to improve performance.
- The incentive rate term must be capable of withstanding changes in industry performance.

We are minded to fix the range of deviation for the remainder of DPCR5, as this provides regulatory certainty on the incentive rate for the DNOs for the remaining three years of this price control.

Next steps

Responses should be sent to the above address for the attention of Stephen Perry or preferably emailed to stephen.perry@ofgem.gov.uk by **31 January 2012**. Unless clearly marked as confidential, responses may be published on our website.

We will review consultation responses and issue a decision letter before 31 March 2012. Alongside this the Authority will issue a direction to give meaning to the Vt, Xt, Yt and Zt terms in Part D of Special Licence Condition CRC8. The Broad Measure of Customer Satisfaction will be implemented on 1 April 2012.

If you have any queries in relation to consultation please contact Stephen Perry by email (stephen.perry@ofgem.gov.uk) or on 0207 901 1806.

Yours faithfully,

Andy Burgess,
Associate Partner, Transmission and Distribution Policy

Appendix 1 – Discussion of options

Option	Statistically recognised range of deviation	Percentage reward or penalty reflects performance	Incentivises licensees to improve performance	Withstands changes to industry performance
1) Maximum minus mean	This is a statistically acceptable method of calculating a range of deviation.	Under this approach the best-performing DNO would automatically achieve their maximum reward. No other licensee would receive their maximum reward or penalty (unless the range of deviation from the mean is equal to the best-performing DNO).	This incentive term incentivises licensees to improve performance relative to the best performing DNO.	Regardless of any changes in industry performance, this approach ensures that the top performing licensee will always receive their maximum reward.
2a) One Standard Deviation	This is a statistically recognised method of calculating a range of deviation. Based on the cumulative data from our six month trial for all four components of the customer satisfaction survey, 29 per cent of licensees have a performance level that falls outside of one standard deviation from the industry mean.	Licensees could be rewarded or penalised inconsistently for statistically insignificant differences in performance. This volatility would exacerbate the impact of any potential issue with data robustness.	One standard deviation from the industry mean would provide the strongest incentive rate for DNOs to improve performance. However, based on the six month pilot survey data, we consider that it is too easy to earn the maximum reward/penalty under this incentive rate option. One standard deviation would not incentivise the best or worst performing licensees to further improve performance, as they are restricted from receiving additional rewards by the cap/collar. See Appendix 4.	The incentive rate would remain fixed at one standard deviation for the last three years of DPCR5. If there is a significant convergence of results over the next three years, then potentially no licensee would receive their maximum reward or penalty. Although given current levels of performance indicated as part of the six month pilot, this is unlikely.

	Statistically recognised range of deviation	**Percentage reward or penalty reflects performance**	**Incentivises licensees to improve performance**	**Withstands changes to industry performance**
2b) 1.5 Standard Deviations	This is a statistically recognised method of calculating a range of deviation. Based on the cumulative data from our six month trial for all four components of the customer satisfaction survey, 14 per cent of licensees have a performance level that falls outside of 1.5 standard deviations from the industry mean.	Based on the pilot survey results, we believe that 1.5 standard deviations would produce rewards and penalties that reflect performance for all DNOs. See Appendix 4. This incentive rate is more sensitive to statistically insignificant fluctuations in performance than 1.75 or two standard deviations.	We believe that this incentive provides an appropriate incentive for all licensees to improve performance.	The incentive rate would remain fixed at 1.5 standard deviations for the last three years of DPCR5. If there is a significant convergence of results over the next three years, then potentially no licensee would receive their maximum reward or penalty. This scenario is more likely to happen than Option 1 or 2a.
2c) 1.75 Standard Deviations	This is a statistically recognised method of calculating a range of deviation. Based on the cumulative data from our six month trial for all four components of the customer satisfaction survey, 11 per cent of licensees have a performance level that falls outside of 1.75 standard deviations from the industry mean.	This option better reflects the licensee's performance as it is less sensitive to statistically insignificant fluctuations in performance than one or 1.5 standard deviations. Rewards and penalties therefore reflect underlying trends in performance.	This option would encourage all DNOs to invest in improving performance, as the percentage reward/penalty received reflects underlying performance. The pilot suggests that the best and worst performers can exceed 1.75 standard deviations from the mean. We believe that this incentive rate provides all DNOs with a good incentive to improve performance.	The incentive rate would remain fixed at 1.75 standard deviations for the last three years of DPCR5. If there is a significant convergence of results over the next three years, then potentially no licensee would receive their maximum reward or penalty. This scenario is more likely to happen than Option 1, 2a or 2b.

	Statistically recognised range of deviation	Percentage reward or penalty reflects performance	Incentivises licensees to improve performance	Withstands changes to industry performance
2d) Two Standard Deviations	This is a statistically recognised method of calculating a range of deviation. Based on the cumulative data from our six month trial for all four components of the customer satisfaction survey, two per cent of licensees have a performance level that falls outside of two standard deviations from the industry mean.	This option best reflects the licensee's performance as it is least sensitive to statistically insignificant fluctuations in performance. Rewards and penalties therefore reflect underlying trends in performance. This more conservative incentive rate term would help alleviate the impact of any potential issue with data robustness.	This option would encourage all DNOs to invest in improving performance, as it best reflects underlying performance. The pilot suggested that it is difficult to exceed two standard deviations from the mean for every component of the CSS. We are therefore concerned that this incentive rate does not provide DNOs with a large enough incentive to improve performance.	The incentive rate would remain fixed at two standard deviations for the last three years of DPCR5. If there is a significant convergence of results over the next three years, then potentially no licensee would receive their maximum reward or penalty. Based on the current industry performance, this scenario is the most likely to affect this option.

Appendix 2 – Maximum upside and downside allowed revenue term per year in DPCR5, 2012-13 to 2014-15 (£ million, 2007/08 prices)[9]

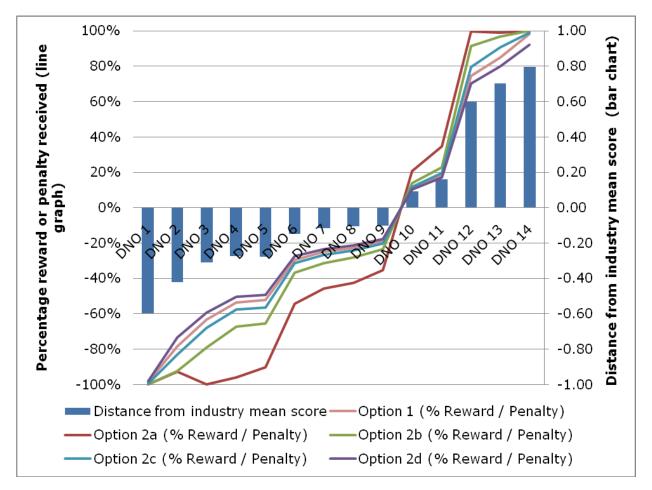| DNO	Maximum Upside [$AROU_t$]	Maximum Downside [$AROD_t$]
EMID	2.9	-1.8
WMID	2.9	-1.8
ENWL	2.6	-1.6
NEDL	1.8	-1.1
YEDL	2.3	-1.4
SWALES	1.3	-0.8
SWEST	1.9	-1.2
LPN	2.5	-1.6
SPN	2.3	-1.4
EPN	3.6	-2.2
SPD	2.5	-1.6
SPM	2.4	-1.5
SHEPD	1.7	-1.0
SEPD	3.4	-2.1

Appendix 3 – DNO performance for each component in the six month pilot survey[9, 10]

DNO	Overall score [OS_t]	Supply Interruptions [$SIAS_t$]	Connections [CAS_t]	General Enquiries [GAS_t]
DNO 1	7.12	7.66	6.63	7.04
DNO 2	7.30	8.23	6.60	6.82
DNO 3	7.41	8.00	6.91	7.21
DNO 4	7.44	8.28	6.81	7.03
DNO 5	7.45	8.15	6.89	7.16
DNO 6	7.57	8.19	6.89	7.69
DNO 7	7.60	8.03	7.24	7.47
DNO 8	7.61	8.06	7.27	7.42
DNO 9	7.62	8.29	6.98	7.54
DNO 10	7.81	8.25	7.37	7.82
DNO 11	7.88	8.15	7.82	7.45
DNO 12	8.32	8.81	7.99	7.98
DNO 13	8.42	8.51	8.40	8.28
DNO 14	8.52	8.79	8.20	8.62
Mean	**7.7**	**8.24**	**7.29**	**7.54**
One Standard Deviation	0.43	0.30	0.59	0.50

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[9] The algebra in table relates to the terms specified in electricity distribution special licence condition CRC8.
[10] The customer satisfaction survey is scored out of ten.