

Our Ref: Your Ref: 190/11

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Stephen Perry The Office of Gas and Electricity Markets 9 Millbank London SW1P 3GE

30 January 2012

Dear Stephen

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

I am writing on behalf of Northern Powergrid Holdings Company and its wholly-owned electricity distribution licensees Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) plc in response to Ofgem's consultation letter on the incentive-rate term that will be used to reward or penalise distribution network operators (DNOs) based on customers' satisfaction with their service from 1 April 2012.

In summary, we consider that Ofgem's view of each option is justifiable and we agree with the range of standard deviations considered by Ofgem. Our responses to the questions posed in the consultation letter are as follows:

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

We think that these four principles are robust enough to allow a tehnical, systematic and impartial method of calculation of the incentive-rate term. Also, these principles encourage competition amongst DNOs to the benefit of the customer and we have already expressed our aspiration for the customer service broader measure to deliver the appropriate positive outcomes for customers. The last principle takes into account future uncertainties and we think that this principle in particular should be considered before agreement on the appropriate standard deviation is reached.

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

Although we do not entirely disagree with 1.75 as choice of standard deviations, we maintain a strong preference for two standard deviations mainly because, at this early stage of the survey, it is the scalar that removes concerns for statistical uncertainty (error in response and non-response bias and standard error) and provides a stable investment incentive mechanism for network operators.

According to the results of the six months of pilot survey, at 1.75 standard deviations there would be six performers to get the maximum reward or penalty whilst, at two standard deviations, only one performer would get the maximum reward. We believe that the variability across the components is covered by two standard deviations, as the only network operator that receives the maximum reward is

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an outlier performer that skews positively the distribution of the scores. This is in line with our stance that exceptional performance should have the maximum reward. At two standard deviations, the other three components do not have a distribution of scores skewed by just one network operator. Exceptionally, we think that if one performer is more than two standard deviations away from the mean to drive the scores on its own, a maximum reward or penalty should be applied. It is our view that the appropriate range of deviation from the overall mean of all licensees that are subject to this condition should be set at two. Below there is a table based on pilot survey six months results, showing the number of network operators with maximum incentive and minimum penalty respectively.

	Overall	Supply Interruption	Connections	General Enquiries	Total	
DNOs outside 1.75 standard deviations	1	3	1	1	6	11%
DNOs outside 2 standard deviations	0	0	0	1	1	2%

We have built a "predictive model" that shows divergence and convergence of customer satisfaction scores distribution for each component, based on different inputs of improvement rates for each quartile of current pilot survey results. This model shows that convergence of results allows more maximum rewards or penalties at two standard deviations (than the dispersion of scores based on six months of results), whilst divergence of results makes it more difficult to achieve maximum reward or penalty.

For example, a scenario in which distribution of scores is converging is one where the upper-half scores improve by 0.2% and the bottom-half scores improve by 2%. The table below is based on this scenario, showing the number of network operators with maximum incentive and minimum penalty respectively.

	Overall	Supply Interruption	Connections	General Enquiries	Total	
DNOs outside 1.75 standard deviations	1	3	1	1	6	11%
DNOs outside 2 standard deviations	0	1	0	1	2	4%

Analysis of the last five years' customer satisfaction results showed an annual improvement rate between 3.5% and -3.7% (taking out the outliers) and our assessment is that, in the short term, it is highly unlikely to see improvement rates extremely higher or lower than these, therefore situations of significant convergence or significant divergence are less likely to occur.

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

We do not believe that Ofgem has overlooked any relevant arguments.

However, we would like to emphasise that we are in the early days of the broader measure incentive scheme and we recognise the possibility of inconsistencies across network operators emerging from future audit processes. In relation to option 2d) for a choice of two standard deviations, we would like to add to your comment "This more conservative incentive rate would help alleviate the impact of any potential issues with data robustness" the fact that two standard deviations is recommended for this early stage of the unaudited processes because it allows only exceptional performers to be rewarded or penalised to the maximum amount.

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

Again, we agree that the addition of a dead band would not add any value to the incentive-rate term established in Part D of electricity distribution special licence condition CRC8. In consequence, our reflection is that there are no other options to be considered at this stage.

For the last question in the consultation letter, we are in full agreement with Ofgem:

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

If this range of deviation is fixed for the remaining three years of DPCR5, the Authority will ensure there is regulatory certainty on the incentive rate. We think that the customer satisfaction broader measure results based on a fixed standard deviation would provide a robust background for comparative and predictive analysis, which will reveal weaknesses in customer service to help each network operator build a stronger performance.

I hope that you will find these comments helpful: if you would like me to enlarge on any of them, please do not hesitate to contact me.

Yours sincerely

David Gill

Head of Customer Service