



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

Promoting choice and value for  
all gas and electricity customers

Our Ref:  
Direct Dial: 020 7901 7159  
Email: Andrew.Burgess@ofgem.gov.uk

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## **Decision on the customer satisfaction survey incentive rate term in Part D of electricity distribution Special Licence Condition CRC8**

This letter sets out our decision following consultation on 20 December 2011<sup>1</sup> on the incentive rate term that will be used to reward or penalise Distribution Network Operators (DNOs) based on customers' satisfaction with their service.

### Introduction

The Broad Measure of Customer Satisfaction<sup>2</sup> is one of a several incentives that we introduced as part of our current price control (DPCR5). The Broad Measure of Customer Satisfaction is implemented on 1 April 2012 and consists of three elements; customer satisfaction survey, complaints metric, and stakeholder engagement.

The customer satisfaction survey element is designed to incentivise improved quality of service by capturing customers' experiences of the services delivered by a DNO. 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)<sup>3</sup>.

The maximum reward / penalty for each DNO licence equates to +0.8%/-0.5% of their base demand revenue in a given year and the incentive amounts per DNO licence area are already specified in the electricity distribution licence<sup>4</sup>. On 20 December 2011 we consulted on the incentive rate term (ie the scaling factor) that should be used for the customer satisfaction survey<sup>5</sup>. *Final Proposals – Incentives and Obligations*<sup>6</sup> specifies that the

<sup>1</sup> Consultation letter on the customer satisfaction survey incentive rate term in Part D of electricity distribution Special Licence Condition CRC8; 20 December, 2012 (Ref no: 190/11)  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=620&refer=Networks/ElecDist/PriceCtrls/DPCR5>

<sup>2</sup> Referred to in electricity distribution Special Licence Condition CRC8 as the "Broad Measure of Community Satisfaction".

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> In electricity distribution special licence condition CRC8, the incentive rate term relates to  $V_t$  for the overall mean component,  $X_t$  for supply interruptions component,  $Y_t$  for the connections component and  $Z_t$  for the general enquiries component. Final Proposals states that the incentive rate term will be based on range of deviation from the industry mean.

incentive rate term should be based on an acceptable range of deviation from the industry mean that is revealed during a pilot survey<sup>7</sup>.

### Consultation

In our consultation we set out four high-level principles that we believed should inform our decision on a suitable incentive rate term. These were -

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

Based on these high level principles and the results of our six month pilot survey, five options were considered for the customer satisfaction survey incentive rate as part of our consultation. These were-

- 1) The range between the maximum licensee score and the industry mean<sup>8</sup>.
- 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.

In our consultation letter we stated that we were minded to set the incentive rate term at 1.75 standard deviations (option 2c) for the remaining three years of DPCR5.

### Responses

We received seven responses. Six were from electricity distribution network companies and one was from a gas distribution network company. All the responses agreed with our high-level principles for making a decision.

Of the responses that recommend a particular incentive rate term, support was split evenly between 1.75 and two standard deviations. No additional options were proposed by the respondents.

Three responses supported using two standard deviations. They considered that two standard deviations gave leading companies more of an incentive to improve performance. They also considered that two standard deviations would better alleviate concern that statistically insignificant differences in performance between DNOs around the mean could lead to very different rewards/penalties. One respondent noted that historically Ofgem's new incentive schemes have a confidence interval of 95% (ie two standard deviations).

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<sup>6</sup> Electricity Distribution Price Control Review Final Proposals - Incentives and Obligations; 7 December, 2009 (Ref no: 145/09)  
[http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP\\_2\\_Incentives%20and%20Obligations%20FINAL.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf)

<sup>7</sup> All licensees participated in a six month pilot of the customer satisfaction survey from May 2011 to October 2011. An anonymised version of the results is outlined in Appendix 4 of our consultation letter that was published on 20 December 2011.

<sup>8</sup> 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 parties who supported our minded to position of 1.75 standard deviations agreed that percentage reward/penalty achieved under 1.75 standard deviations reflected the performance achieved. These responses considered that 1.75 standard deviations provided a suitable incentive for all licences to improve performance and delivered returns for the DNOs that are consistent with the value that we placed on good quality of service during DPCR5 Final Proposals. These parties believed that 1.75 standard deviations represented an appropriate compromise between the high level principles that we outlined in our consultation letter.

There was general support for fixing the incentive rate term for the final three years of DPCR5 to provide regulatory certainty. Two responses noted that if performance was to change significantly, then it might be necessary to revise the incentive rate term during the current price control period. One party recommended that we should use specific numbers based on the six month pilot survey (rather than a rate of standard deviation) to set the incentive rate term, to militate against the affects of convergent industry performance.

Several responses also suggested possible revisions to the Broad Measure of Customer Satisfaction. These suggestions were outside the scope of our decision on the incentive rate term that should be applied for the customer satisfaction survey. For the sake of regulatory certainty, we do not think it is appropriate to make changes to the design of the DPCR5 Broad Measure of Customer Satisfaction at this stage. The data that we collect for the last three years of DPCR5 will be used to inform policy for the next electricity distribution price control (RIIO-ED1).

#### Decision

After considering the responses that we received to our consultation, we have decided to set an incentive rate for the customer satisfaction survey of 1.75 standard deviations (rather than a specific number based on the six month pilot survey). We believe that 1.75 standard deviations best meets the high-level objectives of the incentive rate term set out in this document. Specifically we consider that 1.75 standard deviations best incentivises all DNOs to improve performance whilst providing all licensees with a percentage reward or penalty that reflects performance. To ensure regulatory certainty, this value will be fixed for the three remaining years of DPCR5.

#### Next Steps

To implement this decision, we are issuing a direction to all 14 electricity distribution network licensees to give meaning to the  $V_t$ ,  $X_t$ ,  $Y_t$  and  $Z_t$  terms in Part D of electricity distribution licence Special Licence Condition CRC8<sup>9</sup>. The direction will come into effect on 1 April 2012.

Please contact Stephen Perry at [stephen.perry@ofgem.gov.uk](mailto:stephen.perry@ofgem.gov.uk) or on 0207 901 1806 if you have any queries in relation to this letter.

Yours faithfully,



**Andrew Burgess**  
**Associate Partner, Transmission and Distribution Policy**  
**Duly authorised on behalf of the Gas and Electricity Markets Authority**

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<sup>9</sup> Our direction will be published on Ofgem's website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk)