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26 April 2012

Dear Lia

**Consultation on Ofgem's Approach to Assessing Stakeholder Engagement and Guidance Notes (Reference 24/12)**

We welcome the opportunity to provide our views on your proposed approach to assessing Distribution Network Operators' (DNOs) stakeholder engagement activities.

We place stakeholders at the centre of our business and have, over a number of years, engaged and worked with them to provide the outcomes and services which bring them benefits. Through our RII/O work we have sought stakeholders views on our future business plans to ensure we are delivering the services they require as we work to deliver a low carbon energy sector.

As a company we are committed to working with all our stakeholders as we strive to deliver the networks of the future, and we look forward to continuing our discussions as the Broad Customer Measure and the Customer Satisfaction Output progresses.

For ease of reference, our response is provided in two parts – our high level comments on the incentive mechanism itself including the proposed assessment, and then our more detailed comments on the questions raised.

Should you wish to discuss any aspect of our submission please do not hesitate to contact me. Alternatively for our Gas Distribution business please contact Tracy Hine, ([tracy.hine@uk.ngrid.com](mailto:tracy.hine@uk.ngrid.com), Tel: 01926 656923), or for our Gas and Electricity Transmission businesses, Graham Frankland ([graham.frankland1@uk.ngrid.com](mailto:graham.frankland1@uk.ngrid.com), Tel: 01926 653667)

Yours sincerely

*[By e-mail]*

**Paul Whittaker**  
**UK Director of Regulation**

## **Incentive mechanism**

We welcome the opportunity to comment on the proposed approach to the DNOs stakeholder engagement incentive, one of the elements of the Broad Customer Measure. As such, and in line with the RIIO principles on financial incentives, we believe that it is important to understand the primary output that is being delivered and the criteria or data that will be used to determine performance.

The DNO stakeholder approach proposes an annual award determined by a panel with the membership of the panel changing over time. By its very nature this will therefore be a subjective appraisal of each company's performance. Whilst Ofgem has listed some criteria by which the DNOs will be appraised additional clarity is required as to the relative weightings, and therefore importance the panel will attach to each area.

We recognise and support the benefits to customers and stakeholders of undertaking and acting upon high quality engagement. We would suggest that if the incentive is to retain its discretionary foundations, an alternative Discretionary Reward Scheme (DRS) approach may better facilitate the relevant objective. The Broad Customer Measure could be adapted to incorporate the transfer of this element from the incentive to a specific discretionary scheme.

Notwithstanding the above, we provide below our more detailed comments on your proposed approach.

## **Our views on approach to assessing DNOs stakeholder engagement activities**

### **Proposed Assessment Framework**

We are fully supportive of a transparent process to assess the effectiveness of stakeholder engagement. We further support the principle that networks should be focussing on outcomes and activities resulting from their engagement which brings benefits to stakeholders, rather than the process of engagement itself.

Moving to a process which audits outcomes would enable network owners to provide evidence of their engagement and outcomes aligned to their stakeholders' requirements, with evidence gathering being tailored to suit the preference of individual stakeholders and groups. We are aware from our own experience that stakeholders have different preferences in raising and discussing their requirements with us, together with how they wish to provide feedback. These preferences may change over time and can be catered for in an outcome based approach.

We recognise the panel's difficulty with the previous years' DNO assessment where "DNOs were failing at that time to *measure the benefits and outcomes* of their stakeholder engagement on customers' and business activities". An outcome based approach, centred on measurable benefits, would support both the panel and the companies in providing more objectivity and transparent decision making. This would also give transparency to customers on how their money is being spent, whilst providing companies with a clear link to reward, supporting appropriate investment and innovation.

The panel (as well as companies) would benefit from having a clear, open and auditable set of criteria under which it will operate. There has to be a clear process in place for the DNOs to follow – the panel has to provide feedback to each of the companies on their annual submissions outlining why they have or have not been rewarded, together with any level of reward and the rationale.

There are a number of approaches which can be taken to enable the panel to have a clear set of criteria and a process by which it can review the DNOs stakeholder engagement. Different approaches could be adopted to better suit the nature of the business (for example distribution networks may develop a different approach to transmission businesses). We have outlined at a high level two such approaches below.

One approach which could be adopted by the panel is to reward networks which have developed a proposal following stakeholder feedback which will bring exceptional stakeholder benefits and requires additional funding beyond the agreed regulatory contract. The panel's role would be to consider both the outcomes of the work that has been completed and the proposals for a further significant piece of value-adding engagement and reward the companies accordingly. This concept is similar to how the Low Carbon panel operates.

The panel would have an important role in facilitating activities over and above what is already in hand with stakeholders and can provide the opportunity to provide rewards in addition to the regulatory contract so network companies can develop and deliver exceptional outcomes for stakeholders.

As an example of the above approach our electricity transmission business is undertaking a significant piece of stakeholder engagement on the visual mitigation of our infrastructure. Once this engagement is complete we will then wish to undertake further work based on the recommendation of our stakeholders which will deliver further stakeholder value. Under the approach outlined above the panel would be able to evaluate and reward the stakeholder engagement to date and provide an award for the next phase of stakeholder engagement based on the value it will deliver.

An alternative approach, which we put forward in Annex 1, provides a framework which with development could provide more objectivity and visibility of decision making. This framework also proposes an appeals mechanism for companies to enable a challenge and review to take place. Currently, Ofgem's proposed approach provides no course of redress at either stage of the two stage process. This is particularly important given that the proposed approach does not provide guidance on common criteria, evaluation or weightings. Whilst we understand Ofgem's rationale for not wanting to apply a common evaluation – as standards and accreditations can change over time – the result is that both stages of the assessment process are wholly subjective. There is a risk that relying on subjective assessment may fail to incentivise the right behaviours by network operators and may make the assessment process more difficult and less transparent.

We would be happy to discuss these proposals in more detail.

### **Consultation Questions**

We summarise our response to the specific questions, below:

What other approaches to providing assurance should be considered appropriate?

- a) Whether evidence submitted by DNOs should be subject to a common evaluation or independent audit administered by Ofgem
- b) Whether there is a case for proposing a common assurance approach across all companies – for example a common accreditation standard or survey

A common evaluation will provide additional clarity, objectivity and openness in the decision making process. The decisions made by the panel have to be auditable. In principle we also support a common assurance approach, although following an initial search we are not aware of any recognisable accreditation schemes directly applicable for stakeholder engagement.

2) Your views on our approach to allocating the financial reward

- a) Do you think this is a fair and proportionate approach
- b) Can you suggest any other approaches and why do you think they are appropriate?

The approach should contain a greater proportion of objectivity to ensure transparency and incentivise the right behaviours. The current two stage approach being proposed for the DNOs is wholly subjective and would therefore be difficult to administer in terms of measuring whether a company has delivered positive outcomes for stakeholders. We would welcome the opportunity to discuss our proposals in more detail.

3) Factors the panel should take into account for the assessment of outcomes of engagement

It is unclear how the panel will assess the relative benefits to customers and/or stakeholders which will be presented by the DNOs and therefore how they will reward them. It is also our experience that stakeholders have differing views as to what is important and what should be a priority.

Again it is unclear as to how the panel may evaluate examples against the differing requirements of stakeholders. This is particularly important where the panel is being asked to assess submissions, and to identify leading performers and best practice. Companies are being rewarded for delivering outcomes their stakeholders' value - assessment is therefore specific to the company (and individual network) and industry comparisons are therefore not necessarily relevant. The

broad range of stakeholders, their size and capacity to engage will also need to be taken into account.

This will require a very clear, open and auditable set of criteria to which the panel will operate, with clear processes in place for DNOs to follow. This will also include very clear guidance on providing feedback on DNOs performance and rationale for why they have not / have been rewarded and the level of reward.

- 4) Any additional information or ideas on how the DNOs should be assessed for the purpose of this incentive

We would welcome the opportunity to discuss our proposals outlined in this response in more detail.

- 5) Whether this approach to assessment should be applied to stakeholder engagement incentive schemes in other industries, i.e. gas distribution, gas or electricity transmission

For National Grid the stakeholder engagement incentive, as proposed, would result in circa £20 million per annum being applied on a wholly subjective basis. This is at odds with the rest of the Broad Customer Measure / Customer Satisfaction Output which is objectively measured. For our Gas Distribution business in particular, which is subject to an objective downside incentive on complaint handling, such subjectivity for the stakeholder incentive, would lead to an asymmetrical downside incentive for the Broad Customer Measure overall.

Furthermore we believe that the allocation of such substantial amounts by a panel, using a wholly subjective basis, would not only be challenging for the panel, but also create uncertainty around revenue potential.

- 6) Any concerns or further suggestions about our proposals

We welcome the opportunity to explore alternatives and a more objective framework, particularly in light of the longevity of the incentive.

Whilst the DNO trials will certainly bring learning that can apply to all sectors, we believe that innovative ideas that can be developed under RIIO-GD1 and T1 should be encouraged, rather than be muted through the universal adoption of existing incentives under DPCR5.

### Figure a1.9 – Our proposed framework for the stakeholder engagement incentive

Building on the previous discussions at the Customer and Social Issues Working Group we propose a high level framework which we would welcome the opportunity to discuss further.

Terms of reference for panel members	<ul style="list-style-type: none"> <li>Explicit, transparent and published guidelines as to standards that need to be met for companies to be rewarded</li> </ul>		
Minimum requirements	<ul style="list-style-type: none"> <li>A clearly specified common approach to meeting minimum requirements</li> <li>Measurement clearly defined</li> </ul>		
Appeal mechanism	<ul style="list-style-type: none"> <li>To enable a challenge and review to take place</li> <li>Transparent feedback mechanism on how to improve</li> </ul>		
Main submission <sup>1</sup>	<ul style="list-style-type: none"> <li>Assessed on weighted outcomes. For example:</li> </ul>		
Objective	Outcome	Criteria / Measurement	Example weighting
	Consistent & measurable performance leading to customer /stakeholder benefits	Maintaining accreditation of relevant standard	x%
	Increased customer awareness / improved information enabling stakeholders to engage (encouraging hard to reach)	Range of individuals / groups engaging with networks	x%

<sup>1</sup> Based on Annex 1 - Guidance notes for stakeholder engagement incentive scheme 2011/12 – scope of scheme and principles panel should consider.

Objective/Subjective	Stakeholder initiatives acted upon as a proportion of initiatives generated by stakeholders	<ul style="list-style-type: none"> <li>No of initiatives (can include initiatives acted upon but not necessarily taken forward due to additional/wider engagement or negative cost benefit)</li> </ul> <u>Reward allocated for initiatives that:</u> <ul style="list-style-type: none"> <li>Drive change in company's culture leading to better outcomes</li> <li>Initiatives embedded within broader business processes<sup>2</sup></li> <li>Initiatives recognising future needs of existing customers/stakeholders and new customers/stakeholders</li> </ul> <u>Above reward increased by x% for:</u> <ul style="list-style-type: none"> <li>Measurable benefits to customers/stakeholders that demonstrate wider UK plc benefits</li> <li>Driving best practice, creating industry excellence</li> </ul>	x% (the sum of the three categories below)  x%  x%  (three categories above increased for additional benefit/industry excellence)
Decision making	<ul style="list-style-type: none"> <li>Clear transparency in decision making providing relative strengths of different submissions (against clearly defined and agreed criteria)</li> <li>Feedback mechanism for companies to improve</li> <li>Panel to publish proceedings and clear reasons for awards</li> </ul>		
Appeal mechanism	<ul style="list-style-type: none"> <li>To enable a challenge and review to take place</li> <li>Transparent feedback mechanism on how to improve</li> </ul>		

<sup>2</sup> Could be developed into objective measures, for example measuring how well the network managed charging volatility/stability on an annual basis – a key customer/stakeholder requirement.