

# Incentives – some underlying principles

- **“An awareness that all companies could outperform in theory (i.e. No “median theory” is in play)” – Ofgem City Briefing 16<sup>th</sup> July 2012**
- **RIO model promotes the use of incentives to deliver the primary outputs**
- **The strongest incentives are financial**
- **To effectively incentivise behavioural change:**
  - **Primary output must be within DNOs control**
  - **Target and penalty / reward mechanism must be clear before incentive period commences**
  - **Means for monitoring performance must be defined**

# Achieving effective incentives in ED1

- Ofgem, DNOs and stakeholders agree primary outputs and how they are measured (context of September consultation?)
- Behavioural change identified, e.g. year-on-year improvement against a normalised base (important part of DNO customer engagement)
- Targets set for each DNO to drive behavioural change
  - Targets known upfront, hence DNOs can respond
  - Part of overall package; no conflicting signals
  - Incentivises DNOs to outperform without the risk of penalty.
- Also need to consider how to incentivise DNO frontier shift (if required)

# A possible model

- **To incentivise each DNO to change behaviour**
  - **Prescribed penalty / reward around target derived from individual DNO's actual performance in previous years, e.g. Relative to three-year historic performance**
- **To incentivise the DNO group**
  - **Penalty / Reward for overall performance over the ED1 period – most improvement = reward; decline in performance = penalty**