Incentive for Connections Engagement

Discussion at CONWG

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CONWG – 5 June 2013

Covering....

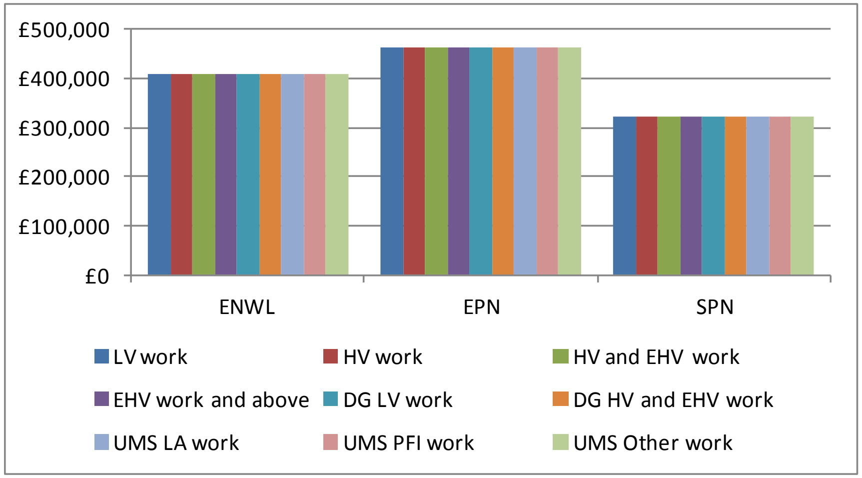
- **Action: JV encouraged the working groups to consider and assess the various options of splitting the penalty and present this analysis at the next meeting.**

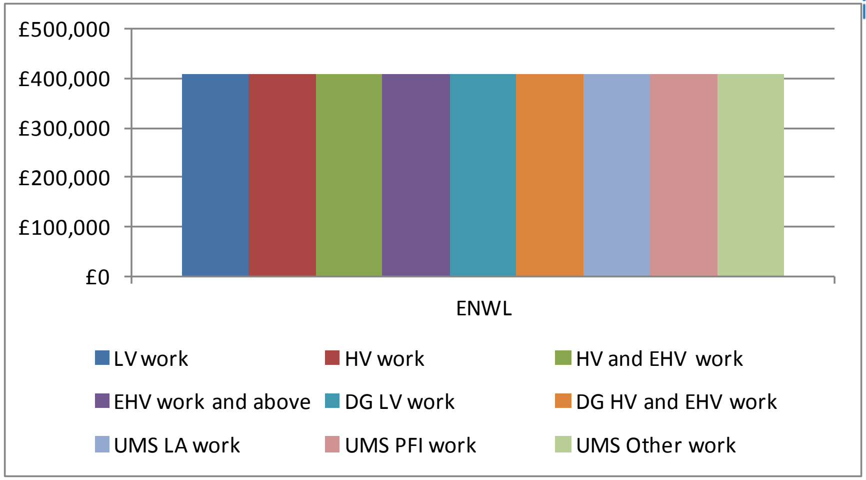
8.24. The ICE is a penalty only incentive. The maximum penalty under the incentive will be 0.9 per cent of base revenue, per annum, per licensee. However, the maximum penalty that can be applied to a DNO will be proportionate to the market segments that have passed the Competition Test (ie if a DNO has not passed the Test for any market segments, then they will be exposed to penalties of 0.9 per cent of base revenue per annum. A DNO that has passed all market segments will face no penalty). We will consult on the approach used to scale the size of penalty (eg relative to the number or value of market segments that have not passed the Competition Test) prior to the start of RIIO-ED1.

Options

- There are a number of options that could be used to scale the size of the incentive across the market segments and each is considered in turn
  - Equal split across all nine market segment
  - Split based on the relative market sizes
  - Split based on relative number of customers
  - Split based on average project size in each segment
- To provide an indicative view of the impact of the different mechanisms three DNOs were modelled where there was some information available on market shares
  - Information is not on a consistent basis and is only to illustrate the differences in the approaches
  - Modelling assumes a minimum of £100k per segment

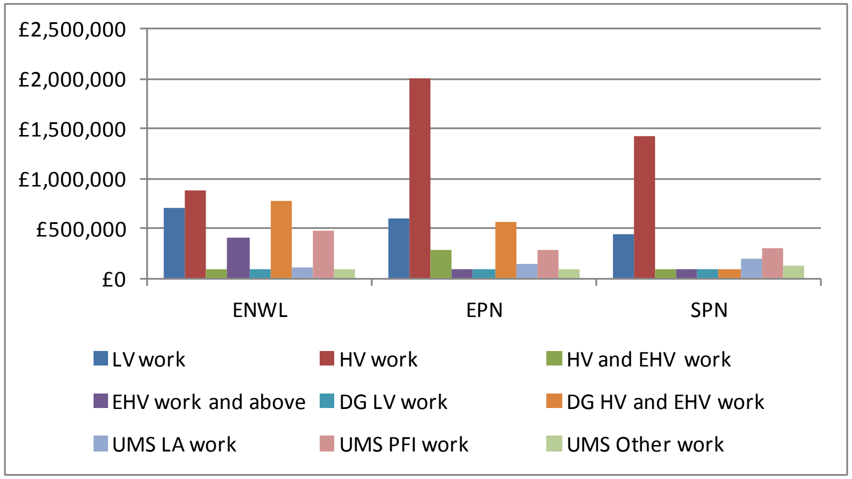
Equal split across all nine market segment

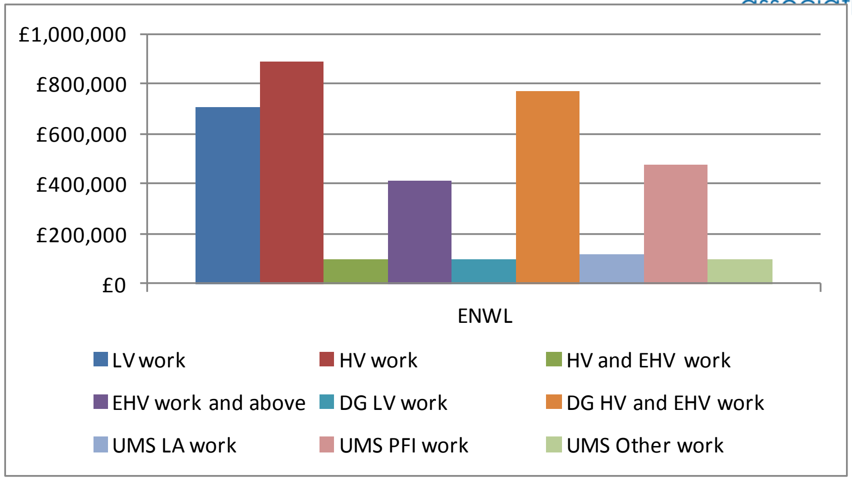




- The actual size of the incentive will vary between DNOs as it relates to Allowed Revenue
- Incentive remains constant over RIIO-ED1 and is know in advance
- No differentiation by segment irrespective of relative size or value
- Provides incentive even where there is currently no market segment for the DNO but may develop in time eg UMS PFI

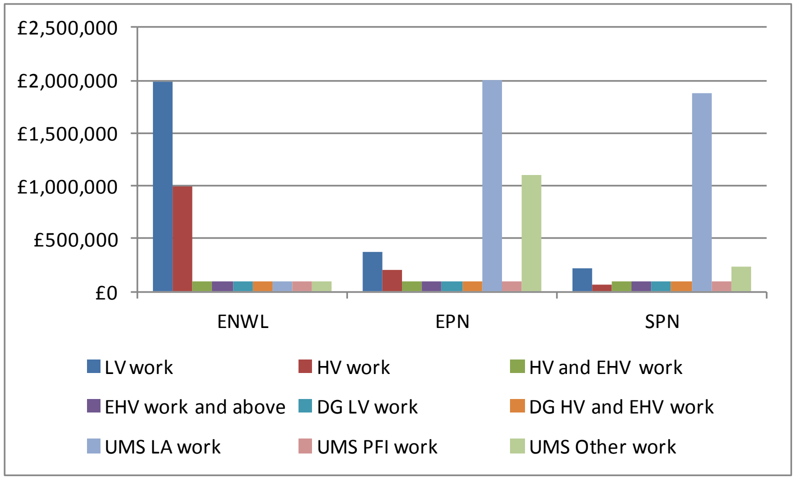
Split based on the relative market value

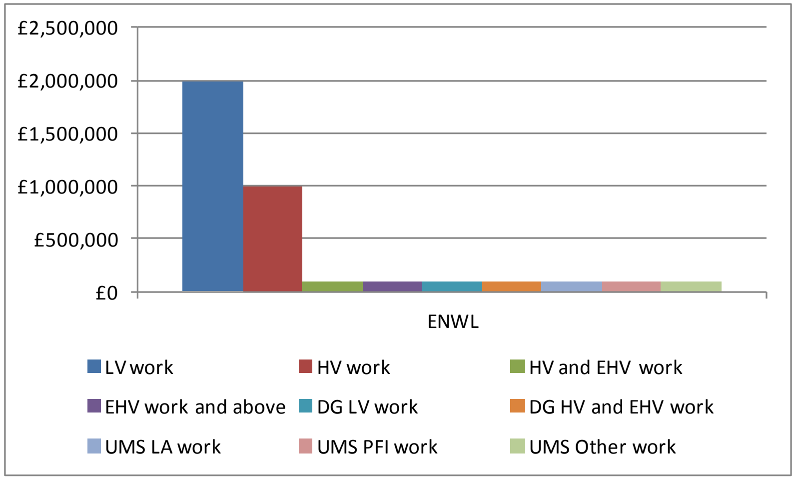




- The actual size of the incentive will vary between DNOs as it relates to market sizes
- Nominally the size of incentive proportionate to size of market
  - But some large segments have small number of customers
- Consistent way to value size of market would be required
- Market sizes may vary over time and would need mechanism to vary, means size of penalty is not know to DNO in advance
  - Could be done in advance and/or reset at a mid point review

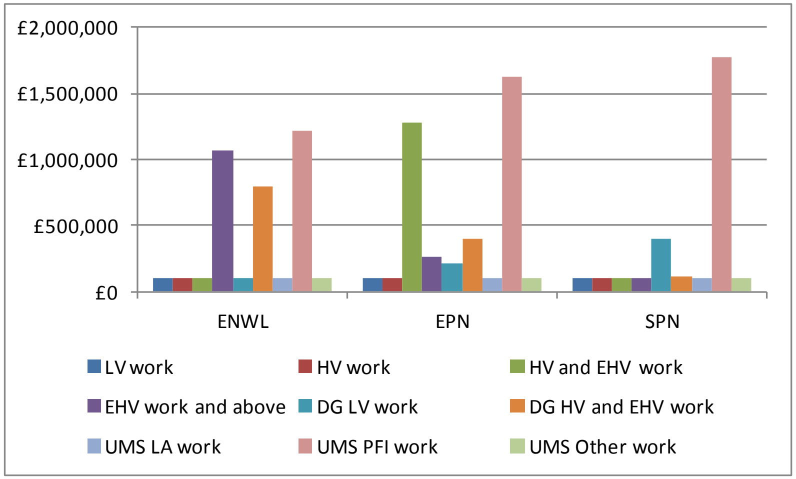
Split based on relative number of customers

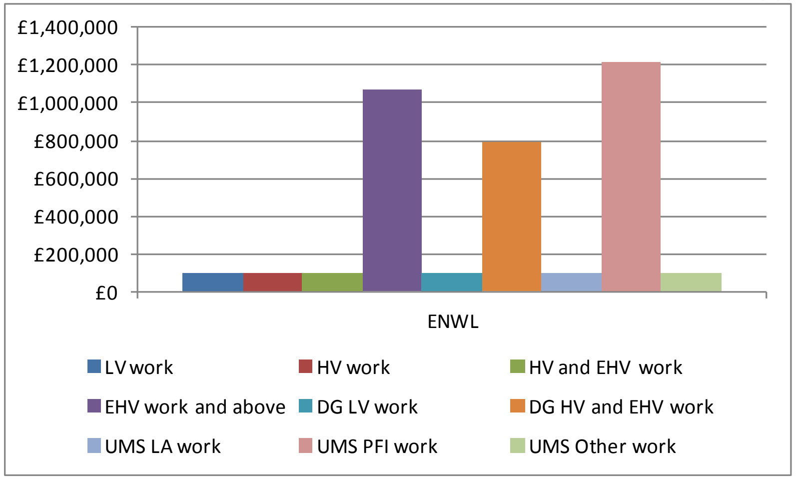




- The actual size of the incentive will vary between DNOs as it relates to number of customers
- Dominated by LV and HV segments with all other segments at £100k minimum
- [Note UKPN based on UMS jobs distorts graphs]
- Consistent way to assess number of customers would be required
- Number of customers may vary over time and would need mechanism to vary, means size of penalty is not know to DNO in advance

Split based on average project size in each segment





- The actual size of the incentive will vary between DNOs
- [Note UKPN based on UMS jobs distorts graphs]
- Consistent way to assess average cost would be required
- May vary over time and would need mechanism to vary, means size of penalty is not know to DNO in advance