James Veaney
Ofgem
9 Millbank
London SW1P 3GE

98 Aketon Road
Castleford
West Yorkshire
WF10 5DS

james.veaney@ofgem.gov.uk
RIIO.ED1@ofgem.gov.uk

Telephone: 01977 605605

30 October 2013

Dear James

**Consultation on RIIO-ED1 customer service and connection incentives**

Thank you for the opportunity to comment on your proposed targets and methodology for the customer service and connections incentives in RIIO-ED1. We are supportive of Ofgem's 'minded to' position throughout the areas covered by this consultation, with the exception of the proposal to equally split the incentive for connections engagement (ICE) across all market segments. We will cover this in detail in response to Ofgem's question in Appendix 4. We will now respond to each of Ofgem's consultation questions in turn.

**Appendix 1: Customer satisfaction survey (CSS)**

*Question 1: Do you agree with setting a common target for all DNOs? If not, why do you consider that we should introduce separate targets for different DNOs?*

> We agree with the proposal to set a common target for all DNOs and using the CSI index to set the target. Our customers do not generally make comparisons between DNOs, rather with other companies that provide products and services with which they have day-to-day dealings across all industries. We believe our customers compare us with service-leading companies and we aim to be among those.

*Question 2: Do you agree with setting a common target for all customer categories? If not, please give reasons for taking an alternative approach.*

> We agree with common targets for all customer categories. We recognise that step-change improvements will take time to implement properly and to realise, as detailed in our 2015-23 Well Justified Business Plan commitments for customer satisfaction, connections and social obligations (Executive Summary, pages 13-18).

*Question 3: Do you agree with our "minded to" approach to calculate the target and the maximum reward/penalty score? If not, please give reasons for taking an alternative approach.*

> We support setting the targets using customer satisfaction data from the UK CSI. This is a sound basis for measuring the performance of DNOs as DNOs need to setting their sights on benchmarking well outside of the utility-network industry. We have already said in our Well Justified Business Plan that we believe that companies like Amazon, First Direct and Marks & Spencer define excellent service in the minds of our customers and we set our standards by reference to them and others like them. Our plan is to be able to deliver experiences that are in keeping with those created by leading companies, without adding to the cost-base of the organisation.

*Question 4: Do you agree with our proposed approach to calculate the incentive rate?*

We believe that Ofgem's approach to divide the maximum reward/penalty exposure by the difference between the target and the maximum reward/penalty score is a reasoned and logical approach that should yield appropriate results based on the performance of the network operators.

*Question 5: Do you agree with the approach used to incorporate unsuccessful calls into the CSS? Do you agree with our "minded to" position of not introducing a deadband or a cap on penalty exposure?*

From a customer service perspective, the efficient handling of customer inbound calls is a key measure of any contact centre, accompanied by a quality service from its advisors and supporting IVR technology. Northern Powergrid therefore agrees that any 'unsuccessful calls' where the telephone network operator is responsible for the call not reaching a DNO should be excluded. Northern Powergrid also agrees with the new methodology resulting in a penalty of 0.02 per cent of base revenue for each per cent of total calls that are unsuccessful; and we agree with the view that network operators are responsible for providing good customer service by enabling the customers to contact them in all situations, including the storm events with widespread supply interruption.

**Appendix 2: Complaints metric**

*Question 6: Do you agree with our proposed approach to calculate the target and the maximum penalty score? If not, please specify your preferred alternative and the reasons why.*

We agree with proposed approach and that the current levels of performance are relatively good when compared with other industries.

*Question 7: Do you agree with our proposed approach to calculate the incentive rate?*

We agree with Ofgem's proposed method to divide the total revenue exposure by the difference between the maximum penalty score and industry target score.

**Appendix 3: Time to connect incentive**

*Question 8: Do you agree with our "minded to" position to set common targets for all DNOs? Please explain why you agree or disagree.*

We agree with common targets for all DNOs as it is easy and straightforward for stakeholders (and ourselves) to make comparisons. Customers who have a national footprint or work with more than one DNO will not be confused by differing targets.

*Question 9: Do you agree with our "minded to" position to set different targets for different types of connection? If not, please explain why and outline your preferred alternative.*

We agree with different targets for LVSSA and LVSSB. Without individual targets, DNOs with a far larger work volume in the LVSSA market segment (where jobs are less complex and so can be completed faster) might benefit from rewards that are simply due to the mix of work they undertake.

*Question 10: Do you agree with our "minded to" position to place an equal weighting on all four elements of the time to connect incentive? If not, please explain why and outline your preferred alternative.*

On balance although there are arguments for doing otherwise, we agree with an even split of the incentives across all four elements of the incentive.

*Question 11: Do you agree with our "minded to" approach to calculate the target and the maximum reward score? If not, please explain why and outline your preferred alternative approach.*

> We believe Ofgem's minded to approach to *calculating the target and the maximum reward score* is a sound one and provides the right incentive for improvements in performance, ultimately ensuring customers are provided with better, faster service.

*Question 12: Do you agree with our proposed approach to set the target/maximum reward score now for the first four years of RIIO-ED1 and then calculate the target/maximum reward score for the final four years based on RIIO-ED1 data?*

> We agree with the minded to approach. Although the targets have been set in an appropriate way based on all the available evidence, the underlying data is currently relatively limited. It is not yet clear how all DNOs are currently performing on the measure, and how difficult it will be for the industry to improve. As a result, re-setting the targets for the second half of the RIIO-ED1 period, once more data is available and a more complete track record has been established for actual performance on the metric, is appropriate.

*Question13: Do you agree with our proposed approach to calculate the incentive rate?*

> We agree with the 'minded to' approach to calculate the incentive rate on a linear profile between the two targets of the upper quartile and 30% better than average. We agree with the methodology that these numbers will change after the first four years of RIIO-ED1. Modelling our current performance on the 'minded to' approach does not put Northern Powergrid in a reward position but we agree with the methodology and our plans are to improve our performance in line with the proposed targets.
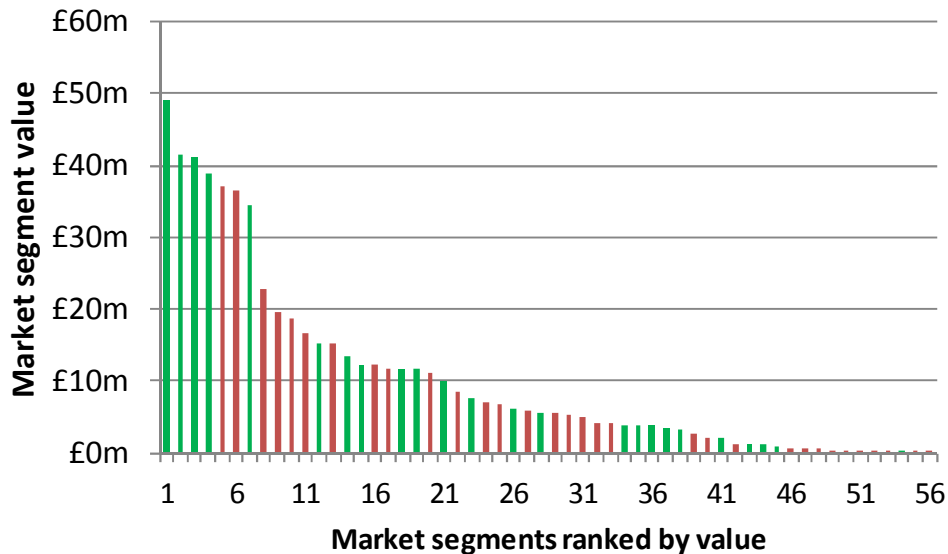
**Appendix 4: Incentive on Connections Engagement**

*Question 14: Do you agree with splitting the penalty equally across the market segments? If not, please explain why and give details of your preferred alternative.*

> Northern Powergrid does not agree with the proposal to split the potential penalty under the ICE equally across nine market segments.

> To do so would fail to take into account significant differences in the economic value of work being undertaken in different market segments. This economic value represents the best available measure of the value customers will place on effective engagement by DNOs.

> The competition notices submitted to date by the various electricity distribution companies highlight this. The chart below reproduces the data on market value for all the market segments for which it is available, from competition notices submitted by various electricity distribution companies.

**Market segment value** (y-axis): £0m, £10m, £20m, £30m, £40m, £50m, £60m

**Market segments ranked by value** (x-axis): 1, 6, 11, 16, 21, 26, 31, 36, 41, 46, 51, 56

*Key: Green bars represent segments that have passed the competition test. The other segments have either not yet been judged by Ofgem, or have failed the test to date.*
*Note: The data is for 2011/12 and has almost 50% coverage by number of segments*

The chart illustrates that the largest market segments that have not yet passed the test have over 2000 times the value of the smallest market segments (excluding those with no activity in 2011/12). To apply an equal potential penalty to such different markets risks that potential penalty being grossly disproportionate.

- In those segments where market value is highest (HV and LV demand), commonly tens of millions of pounds in an individual distribution services area, a potential penalty of 0.1% of a distribution company's revenue will leave Ofgem with financial stick with which to encourage good engagement that is small relative to the value placed on that engagement by customers in the segment.

- Meanwhile, in segments where there is typically very little activity, say one million pounds per annum or less, 0.1% of a distribution company's revenue will give rise to the risk of penalties for inadequate engagement as large as the whole market. This could encourage electricity distribution companies to focus their efforts on these segments to the detriment of others, and/or give the customers in these market segments a disproportionate influence on the service they receive.

There are a number of alternatives that would match much more closely the value likely to be placed by customers on engagement. One is the market value of work being undertaken in each segment.

Market value in each segment would of course need to be estimated. This should not present practical difficulties given that several distribution companies have already developed their own internal estimates of market value by segment. If Ofgem wished to develop a common approach to estimating market value, this should not be challenging. We set out at Appendix 1 an illustrative framework, which would only require data already tracked by electricity distribution companies. This indicative framework could be developed and refined, based on the experiences of distribution companies collectively, before implementation.

We note that Ofgem has raised practical concerns with adjusting market values each year, since this would mean companies would not have the benefit of certainty over the penalties to which it was potentially exposed. Similarly, stakeholders have raised practical concerns that a fixed market value based split for the whole of the RIIO-ED1 period could fall out of

kilter with actual activity (given relative market valuations could change over the course of several years).

Both of these concerns could be addressed by setting an initial split based on existing market values, implement high level annual reporting of estimated market values, and then undertaking an update to the market value split for years four-eight of the RIIO-ED1 period based on data from the first three. The framework for estimating market value set out at Appendix 1 could be used for this process.

We also note that Ofgem's consultation document highlights that electricity distribution companies can segment the connections market in alternative ways to the nine segments typically used by Ofgem:

*We have split the major connections market into nine market segments, based on connection type and the maximum voltage level of the works involved (as outlined in Table 4.1). DNOs also have flexibility to segment the major connections market in the way that they deem most appropriate. If a DNO chooses to take this approach, we will require them to explain why this is appropriate.*

This ability, which is recognised by the current special licence condition (CRC 12), could allow DNOs to combine segments, or disaggregate them. We note that by combining some of the smaller segments which appear to have similar characteristics, and splitting other larger segments which encompass disparate types of work, it would be possible to develop a set of market segments which are more equal in terms of their respective market values. For example, based on the pattern of competition test passes seen across the country at present:

- all DNOs which have passed the test in the EHV with LV or HV market segment have also passed the test in the EHV only market segment, indicating that these segments may have similar characteristics; and

- a competition test pass in the unmetered PFI market segment has been accompanied by a pass in the unmetered local authority market segment, in all regions except London, again indicating that the segments have similar characteristics.

We support this flexibility to combine or disaggregate the existing market segments. We note that, where a company has already passed the competition test in two segments, it will have no incentive to propose to merge those segments for the purpose of a further competition test and splitting the future ICE potential penalty. Nevertheless, this should not prevent Ofgem from considering on its merits any proposals from companies to merge (or split) the market segments which were originally developed for the purposes to implementing DPCR5.

Finally, if using an equal split of the potential penalty between market segments, rather than a split based on value, Ofgem should develop principles to inform the size of any actual penalty that take into account the number of customers affected and the value of work involved. This would help to mitigate the scope for small numbers of customers in one of the smaller market segments to have a disproportionate influence on the service they receive, and potentially draw resources away from other segments where greater benefits from those resources might be felt by other customers, for instance because those other segments contain large numbers of customers in the market for high value work.


Yours sincerely

**JOHN BARNETT**
**Commercial Director**

# Appendix 1 – framework for estimating market values

An indicative approach to estimating market values for each of the current market segments is set out below.

The following acronyms have been used:

- S16A: connections contracted under section 16A of the Electricity Act (1989)
- SLC15: points of connection works, contracted under electricity distribution standard licence condition 15
- kVA: total capacity, in kVA, of connections contracted within a given regulatory year in a given market segment
- AV: actual value of contestable work on connections in a given market segment, measured by the amount the connectees are paying for that work
- EV: estimated value of the contestable work on connections in a given market segment

Existing reporting requirements mean that DNOs measure all of the components necessary to calculated total market value except for the value of connections made under SLC15 (since the overall connection is provided by a third party).

To estimate total market value an estimate of the value of SLC15 connections is needed. This would need to be based on a comparable metric that is known for all SLC15 connections in a market segment (e.g. kVA capacity, or simply the number of connections in the case of unmetered connections) multiplied be an assumption on the value of each unit of this comparable metric (e.g. £ per kVA, or £ per connection). This assumed value could be set either nationally, by reference to an industry average, or in a licensee specific way, for example by reference to the average value per kVA of S16A connections that each electricity distribution licensee has undertaken.

*LV demand*

Estimated total market value shall equal:

> AV S16A LV demand + EV SLC15 LV demand

Where EV SLC15 LV demand will be estimated as:

> kVA SLC15 LV demand x (AV SLC16A LV demand / kVA SLC16A LV demand)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

*HV demand*

Estimated total market value shall equal:

> AV S16A HV demand + EV SLC15 HV demand

Where EV SLC15 HV demand will be estimated as:

> kVA SLC15 HV demand x (AV SLC16A HV demand / kVA SLC16A HV demand)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

*LV or HV with EHV demand (HV&EHV demand)*

Estimated total market value shall equal:

AV S16A HV&EHV demand + EV SLC15 HV&EHV demand

Where EV SLC15 HV&EHV demand will be estimated as:

kVA SLC15 HV&EHV demand x (AV SLC16A HV&EHV demand / kVA SLC16A HV&EHV demand)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

*EHV demand*

Estimated total market value shall equal:

AV S16A EHV demand + EV SLC15 EHV demand

Where EV SLC15 EHV demand will be estimated as:

kVA SLC15 EHV demand x (AV SLC16A EHV demand / kVA SLC16A EHV demand)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

*LV distributed generation (LV DG)*

Estimated total market value shall equal:

AV S16A LV DG + EV SLC15 LV DG

Where EV SLC15 LV DG will be estimated as:

kVA SLC15 LV DG x (AV SLC16A LV DG demand / kVA SLC16A LV DG)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

*HV or EHV distributed generation HV&EHV DG)*

Estimated total market value shall equal:

AV S16A HV&EHV DG + EV SLC15 HV&EHV DG

Where EV SLC15 HV&EHV DG will be estimated as:

kVA SLC15 HV&EHV DG x (AV SLC16A HV&EHV DG demand / kVA SLC16A HV&EHV DG)

As noted above, the value per kVA used to estimate the value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

### Unmetered local authority (ULA)

Estimated total market value shall equal:

AV S16A ULA + EV SLC15 ULA

Where EV SLC15 ULA will be estimated as:

Number of SLC15 ULA x (AV SLC16A ULA / number of SLC16A ULA)

As noted above, the value per connection used to estimate the total value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

### Unmetered PFI (UPFI)

Estimated total market value shall equal:

AV S16A UPFI + EV SLC15 UPFI

Where EV SLC15 UPFI will be estimated as:

Number of SLC15 UPFI x (AV SLC16A UPFI / number of  SLC16A UPFI)

As noted above, the value per connection used to estimate the total value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.

### Unmetered other (UO)

Estimated total market value shall equal:

AV S16A UO + EV SLC15 UO

Where EV SLC15 UO will be estimated as:

Number of SLC15 UO x (AV SLC16A UO demand / number of  SLC16A UO)

As noted above, the value per connection used to estimate the total value of SLC15 connections could be based either on recent data from the distribution company in question for SLC16A connections, or an industry based average established by Ofgem for the purpose of undertaking these calculations.