

DNOs, ICPs, IDNOs, connection customers, consumer groups and representatives and other interested parties

Direct Dial: 0207 901 1861
Email: james.veaney@ofgem.gov.uk

Date: 02 December 2013

Dear Stakeholders,

RIIO-ED1¹ customer service and connection incentives

In March 2013 we set out in our Strategy Decision what outputs each electricity distribution network operator (DNO) needs to deliver during the next price control period (RIIO-ED1).² In September 2013, we consulted on how the detailed customer service and connections incentives will work during RIIO-ED1. We sought views on our proposals.³

We have taken into account the responses to the consultation and this letter details our decision on the arrangements for the RIIO-ED1 customer service and connection incentives.

Background

DNOs will be incentivised to deliver high quality outputs in relation to customer service and connections during RIIO-ED1. We expect DNOs to provide customers with good service and we expect them to proactively engage with their customers to understand and meet their needs.

Customer service

RIIO-ED1 retains the Broad Measure of Customer Service to encourage DNOs to deliver good customer service. The Broad Measure of Customer Service consists of three elements-

- a customer satisfaction survey (CSS)
- a complaints metric
- a stakeholder engagement incentive.

Connections

RIIO-ED1 also includes specific incentives to drive DNOs to provide a better service for connection customers. These include:

- a time to connect incentive
- an incentive on connections engagement (ICE).

¹ The next electricity distribution price control, RIIO-ED1, will be the first to reflect the new RIIO model and will run from 1 April 2015 until 31 March 2023.

² RIIO-ED1 Strategy Decision <http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/riio-ed1/consultations/Documents1/RIIOED1DecOutputsIncentives.pdf>

³ https://www.ofgem.gov.uk/sites/default/files/docs/2013/09/riioed1_custservice_connection_incentives_open_letter_040913.pdf

Consultation

Between 4 September and 30 October 2013, we sought stakeholder views on the detailed arrangements for our RIIO-ED1 customer service and connection outputs and incentives -

- The arrangements for the CSS. Specifically, we consulted on target levels of performance, the approach for calculating penalties/rewards and how to penalise DNOs if they are unable to answer calls from customers during a power cut.
- How to set the target and calculate penalties for the complaints metric.
- The arrangements for the time to connect incentive. Specifically, we consulted on the target, the approach to calculating the reward, and how to split the reward across the different parts of the incentive.
- Our proposals to split the penalty for the Incentive on Connections Engagement (ICE), across each of the connection market segments.

Decision

Following responses to our September consultation and input from stakeholders through the relevant RIIO-ED1 working groups (the Customer and Social Issues Working Group (CSIWG)⁴ and Connections Working Group (ConWG))⁵, we have made the following decisions on the RIIO-ED1 customer service and connection incentive arrangements.

Customer satisfaction survey

We will set common targets for all DNOs and all categories of customer. This approach is supported by the majority of respondents and ensures that customers receive a similar quality of service, regardless of their location or the service provided.

The target and maximum reward/penalty scores⁶ for RIIO-ED1 CSS are outlined in Table 1 below. In coming to our decision we have taken account of service levels across a range of industries. The maximum reward/penalty scores are based on 1.75 standard deviations from the mean and will ensure that any DNO that scores significantly above or below the average will incur its maximum reward or penalty. We consider that the package is fair and should ensure that customer service delivered is good compared with other competitive industries.

Table 1: RIIO-ED1 CSS maximum penalty/reward score and target

Maximum Penalty Score	Target	Maximum Reward Score
6.8	8.2	8.9

We will determine the incentive rate by dividing the annual revenue exposure by the difference between the maximum reward or penalty score and the target score. Since we are structuring this incentive around fixed points (eg the target, the maximum reward/penalty and the incentive), we do not consider that having different incentive rates for rewards and penalties will undermine investment to improve customer service.

For the interruption element of the customer satisfaction survey, DNOs will be penalised 0.02 per cent of annual base revenue⁷ for each one per cent of calls to the DNO that are unsuccessful. This approach is supported by the majority of stakeholders. We will work with

⁴ The RIIO-ED1 Consumer and Social Issues Working Group (CSIWG) is an industry working group consisting of Ofgem, DNOs and other relevant parties. This was established to provide a forum to discuss price control policy issues relating to our customer and social outputs.

⁵ The RIIO-ED1 Connections Working Group (ConWG) is an industry working group consisting of Ofgem, DNOs and other relevant parties. This was established to provide a forum to discuss price control policy issues relating to our connections outputs.

⁶ The Maximum Reward Score is the score at which the company incurs 100 per cent of its reward exposure. The Maximum Penalty Score is the score at which the company incurs 100 per cent of its penalty exposure.

⁷ To be consistent with our other RIIO-ED1 incentives, this will be converted into Return on Regulatory Equity (RORE) basis points and set as a £m figure in the licence.

the CSIWG to improve the consistency of reporting and establish a definition for what constitutes an 'unsuccessful call'. If the number of telephone calls falls significantly during RIIO-ED1 then we may review the appropriateness of this mechanism.

Detailed guidance on how the DNOs should undertake the CSS will be set out in the RIIO-ED1 Regulatory Instructions and Guidance (RIGs). To maintain the simplicity and consistency of our arrangements and to reduce costs, we do not envisage using multiple methods of surveying customers.

The customer service provided to independent connection providers (ICPs) will not be captured as part of the CSS due to concerns about developing a statistically robust methodology for sampling a relatively small number of ICPs. The provision of non-contestable services will be captured as part of the ICE.

Complaints metric

The target and maximum reward/penalty score for the RIIO-ED1 complaints metric are set out in Table 2 below. We note that these arrangements may expose DNOs to a much greater level of penalty than the existing incentive arrangements. However, we consider that this is appropriate as it will provide a strong incentive for poorer performing DNOs to improve.

Table 2: RIIO-ED1 Complaints Metric Target and Maximum Reward Score

Target	Maximum Reward Score
8.33	14.84

We will determine the incentive rate by dividing the total revenue exposure by the difference between the maximum penalty score and the industry target score.

Time to Connect Incentive

We believe that connection customers should expect a consistent level of service across GB. We will therefore set common targets for all DNOs. Based on the data available, we consider that there is a sufficient difference in the work required to provide quotations and complete connections for single service low voltage (LV) customers and single project LV customers to justify having separate targets for each type of connection customer.

The target and maximum reward score for the first four years of RIIO-ED1 are outlined below. Based on current levels of performance, and targets DNOs have set themselves in their RIIO-ED1 business plans, we consider that the performance levels required to achieve the maximum reward score are stretching but achievable.

Table 3: RIIO-ED1 Time to Connect Target and Maximum Reward Score

	Connection Size	Target (working days)	Maximum Reward Score (working days)
Time to Quote	LVSSA ⁸	8.21	6.4
	LVSSB ⁹	11.73	10.12
Time to Connect	LVSSA	42.08	32.47
	LVSSB	52.70	39.91

We have not identified a compelling reason to place a stronger weighting on any one element of the incentive. We will therefore place equal weighting on all four elements of the incentive. However, if the incentive is not producing the desired outcomes (eg if the incentive has delivered significantly quicker quotations, but has not improved the time taken to deliver a completed connection) then we may reconsider how the incentive has been spread across the different elements of the incentive.

⁸ Single service Low Voltage (LV) connection

⁹ Small project demand connection (LV)

We will revise the target and maximum reward score after four years of RIIO-ED1. The revised target and maximum reward score will be calibrated based on industry performance data during the first few years of RIIO-ED1. We do not intend to fix the methodology for calculating the revised values now as we are unsure about the level of data volatility and the potential level of improvement that this incentive could deliver.

We acknowledge that some connections may have timescales that are considerably longer than average. However, to maintain the simplicity of our incentive arrangements we have decided that no exemptions will apply. We consider that this is appropriate since the data used to derive the target and maximum reward score does not include exemptions.

We will set the incentive rate by dividing the reward exposure by the difference between the maximum reward score and the industry target score.

Incentive on Connections Engagement

We recognise the appeal of structuring the incentive relative to the value of each market segment. We remain concerned however as to how this value would be calculated and whether the 'need' for engagement with different types of connections customers always equates to the 'value' of work in a market segment. We will therefore split the penalty equally across all the market segments (either the nine relevant market segments or alternative market segments proposed by the DNO).

This will ensure that all DNOs have an incentive to engage and respond to all connection customers who may not have the ability to use competitive alternatives. We also recognise that this approach allows the incentive value to be known upfront and is supported by the majority of stakeholders.

Under ICE, each DNO will be required to develop a forward looking workplan and also demonstrate how they have engaged with a broad range of consumers and established relevant performance indicators. Subsequent submissions should demonstrate performance against their relevant performance indicators and progress against the delivery of their workplan. A DNO will incur a penalty if we consider that they have not satisfied a set of minimum requirements for that market segment.

The penalty will not apply to market segments where we consider that effective competition exists. In these circumstances we consider that the pressure of effective competition should ensure that customer's interests are met either by the DNO or an alternative. In these market segments, we still expect DNOs to engage and demonstrate how they are responding to the needs of customers that require non-contestable services. Performance in this regard however will not be subject to financial penalties.

We will work with stakeholders to provide more clarity on the assessment process through our RIIO-ED1 Connections Working Group. We intend to trial assessment arrangements next summer (Summer 2014).

Consultation responses

We received 11 responses to our consultation from a range of organisations.¹⁰ Respondents were broadly supportive of the proposals; however some respondents raised specific comments on aspects of the incentive design.

¹⁰ The responses to our consultation can be found here <https://www.ofgem.gov.uk/publications-and-updates/consultation-riio-ed1-customer-service-and-connection-incentives>

Customer satisfaction survey

The majority of respondents were supportive of setting common targets for all DNOs and for all categories of customers. One DNO considered that there were regional factors, outside of its control, that impacted its performance. However it acknowledged that there is a lack of compelling evidence to justify setting alternative targets.

Respondents were broadly supportive of our approach to calculate the target and maximum reward/penalty score. However, one DNO considered that the proposed maximum penalty score of 6.8 was too low and highlighted that in 2012-13 all DNOs had scored above this level. Another DNO noted that the proposed approach creates asymmetric penalty and reward incentive rates, and considered that this could undermine certainty in the return on investment.

No respondents raised any issues with our approach to calculate the incentive rate.

All respondents supported the proposed approach to penalise DNOs if customers are unable to contact them about a power cut. However several respondents raised concerns about the definition of an 'unsuccessful call'. Most notably, one DNO suggested excluding calls that are abandoned by the DNO during a storm event, if the customer first hears a pre-recorded message. Two DNOs suggested reviewing our proposed approach for penalising DNOs for unsuccessful calls, if the number of telephone calls received by the DNO decreases significantly during RIIO-ED1.

Outside of the questions asked in the consultation, one respondent suggested that the survey arrangements could be amended to include alternative methods of surveying customers (eg a postal or internet survey). Another respondent also suggested that the population surveyed should be enlarged to capture ICP customers.

Complaints metric

Almost all respondents supported our proposed approach to calculate the target and maximum penalty score. No respondents raised any issues with our proposed approach to calculate the incentive rate.

One DNO noted that our proposed approach to calculate the target/maximum penalty score exposes DNOs to a much greater level of penalty than the current DPCR5 arrangements. This DNO suggested that maximum penalty score could be based on the average worst performing DNO scores for 2011-12 and 2012-13 instead.

Time to connect incentive

The majority of respondents were supportive of common targets for all DNOs and separate targets for different connection sizes. One respondent did not consider that there was a strong rationale to set different targets for one-off connections and small projects, since both involve similar activities.

Almost all respondents were supportive of our approach to calculate the target/maximum reward score. One DNO had concerns that factors outside a DNO's control could make targets unachievable and suggested that where this was the case these connections could be excluded from the metric. Another DNO supported the target level of performance but considered that the level of performance required to achieve the maximum reward was unrealistic. As a result this DNO did not believe the level of the targets acted as an appropriate incentive.

All respondents supported reviewing the targets/maximum reward score after four years. One DNO encouraged us to decide the methodology for resetting the targets now, to provide greater certainty to the DNOs.

The majority of respondents, including all DNOs, supported splitting the reward equally across the different aspects of the incentive. One respondent considered that a stronger weighting should be placed on completed connections, to avoid placing undue weight on producing quotations which are subsequently not progressed. Another respondent suggested that the maximum reward placed on each element of the incentive could be reviewed after four years, to ensure that the incentive focuses on the appropriate areas.

No respondents raised any issues with our approach to calculate the incentive rate.

Incentive on Connections Engagement

The majority of respondents supported splitting the value of the penalty equally across each of the relevant market segments¹¹ or the alternative market segments proposed by the DNO. One DNO and a connection customer supported splitting the value of the penalty across the market segments based on market value, to ensure it was proportionately sized. The DNO that favoured this approach also suggested a framework for estimating market value. If we were to use an equal split, the same DNO suggested that we should develop principles to inform the size of any penalty, to mitigate against a DNO incurring a disproportionately large or small penalty.

Some respondents suggested that the ICE penalty should also apply to market segments that pass the Competition Test, to ensure that DNOs remain incentivised to deliver a good service to these connection customers.

Outside of this consultation, several respondents wanted more clarity on how performance would be assessed under this incentive during RIIO-ED1. One stakeholder suggested that other types of work (eg disconnections and fault repairs) could also be captured by this incentive.

Next Steps

We will incorporate these decisions into the RIIO-ED1 fast-track licence that we are due to consult on shortly.

Over the next year, we will work with stakeholders to develop the detailed reporting requirements for each of our incentives (eg the definition of an 'unsuccessful call' and 'time to connect') as part of the RIGs.

We will continue to work with industry stakeholders to develop the Stakeholder Engagement Incentive Guidance document and the ICE Guidance document, ahead of our trial assessments in summer 2014.

If you have any questions about this decision or would like to get involved with our work going forward, please email us at RIIO.ED1@ofgem.gov.uk or phone us on 0207 901 1861.

Yours faithfully,



Hannah Nixon
Senior Partner, SG&G: Distribution

¹¹ In DPCR5 Final Proposals we considered that competition was viable in nine market segments of the connection market. We named these market segments, the "relevant market segments". The nine relevant market segments are described in or determined in accordance with Appendix 1 of Charge Restriction Condition 12 (Licensee's Connection Activities: Margins and the development of competition).