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for energy consumers

DNOs, GDNs, TOs and other  
interested parties

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Dear Stakeholders,

### **Stakeholder Engagement Incentive reward consultation**

We introduced a new Stakeholder Engagement Incentive for the current electricity distribution (DPCR5, 2010-2015), gas distribution (RIIO-GD1, 2013-2021) and transmission (RIIO-T1, 2013-2021) price controls.

Under this incentive, a network company may receive a financial reward depending on the quality of its stakeholder engagement. Performance is assessed by an independent panel of consumer and stakeholder engagement experts ('the Panel'). In making its assessment, the Panel awards a score out of 10.

This consultation seeks views on how the Panel's score should be converted into a financial reward for all network companies.

We are also consulting on whether the reward available for the electricity distribution network operators (DNOs) should be indexed in line with inflation (as measured by the Retail Price Index).

#### Background

The Stakeholder Engagement Incentive is intended to encourage DNOs,<sup>1</sup> gas distribution network operators (GDNs) and Transmission Operators (TOs)<sup>2</sup> to engage effectively with a wide range of stakeholders and use this to inform how they run their businesses.

To measure how well network companies engage with stakeholders, all network companies submit an annual report on their engagement activities to us. Those network companies that meet our minimum criteria<sup>3</sup> are then assessed by the Panel.

The Panel scores each company out of 10 across five weighted criteria,<sup>4</sup> to calculate an overall panel score.<sup>5</sup> This score is used to determine the financial reward for each company.

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<sup>1</sup> The electricity distribution Stakeholder Engagement Incentive was introduced in April 2012 and the first live assessment took place in the summer of 2013. The results of the 2012/13 electricity distribution Stakeholder Engagement Incentive reward can be found here: <https://www.ofgem.gov.uk/ofgem-publications/84931/report2012-13electricitystakeholderengagementpanelfinal.pdf>

<sup>2</sup> The gas distribution and transmission Stakeholder Engagement Incentive was introduced in April 2013. The results of the trial in Summer 2014 can be found here: <https://www.ofgem.gov.uk/publications-and-updates/report-gas-distribution-stakeholder-engagement-incentive-scheme-trial-2012-13-0>  
<https://www.ofgem.gov.uk/publications-and-updates/report-gas-and-electricity-transmission-stakeholder-satisfaction-output-trial-2012-2013>

<sup>3</sup> The minimum criteria are specified in this consultation document: <https://www.ofgem.gov.uk/ofgem-publications/85900/seguidanceconsultation06feb2014.pdf>

<sup>4</sup> The current criteria are:

- Initiatives that best serve specific interests of challenging groups of customers/communities/future stakeholders and result in measurable benefits;

## What we are seeking views on

How the overall panel score is converted into a financial reward has not been specified in any of the relevant licence conditions.

For the 2012-13 electricity distribution Stakeholder Engagement Incentive (the first year of the incentive) we converted the panel score out of 10 into a percentage of the DNOs' overall revenue exposure, to calculate the value of the financial reward (Option A below).

However, this approach has raised two potential issues:

1. Rewarding poor performers: Even if the Panel considers that a company's activities are poor, it will still receive a financial reward. For example, if a company scores 1 out of 10 it would still receive 10 per cent of its reward exposure.
2. The full value of the incentive may not be achievable: Given the qualitative nature of the assessment, it may be unlikely that the Panel would award a score of 10 out of 10. This may, therefore, make it difficult for companies to realise the full value of the incentive, thereby reducing its influence on their activities. We consider that the full value of this incentive should be challenging, but achievable.

To address these issues and provide transparency and certainty, we have decided to consult on how we will convert the overall panel score into a financial reward.

## Options

We have considered three high level approaches for converting the score to reward which are outlined in Table 1 (and profiled in Figure 1).

**Option A:** This option reflects the approach that we used for electricity distribution companies last year. The score out of 10 is converted into a percentage of the companies' overall revenue exposure to calculate the value of the financial reward.

**Option B:** Under this option, companies that score below 2 out of 10 would not receive a reward ('threshold score<sup>6</sup>'). Companies that score 8 out of 10 or above would receive the maximum reward ('maximum reward score<sup>7</sup>'). Between 2 and 7.99 out of 10, the incentive rate mirrors the "Option A" incentive rate (e.g. a company that scores 4 out of 10 would receive 40 per cent of its overall revenue exposure).

**Option C:** This option is a variant of Option B but with both a higher threshold and maximum reward score. Under this option, companies need to score above 4 out of 10 to receive a reward and 9 out of 10 or above to receive all of their reward. There is a straight line incentive rate between the threshold and maximum reward score.

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- Initiatives that reflect innovative thinking in responding to needs of stakeholders;
  - Initiatives which are part of holistic approach embedded in business;
  - Initiatives which are supported by robust project management processes and appropriate resources;
  - Initiatives resulting from stakeholder engagement activities which may be recognised as smart practice and could be replicated across the industry.

<sup>5</sup> On the panel scorecard, any score below five is described as 'weak', a score of five is described as 'average', a score of six or seven is described as 'fair', a score of eight is described as 'good' and a score of nine or above is described as 'excellent'.

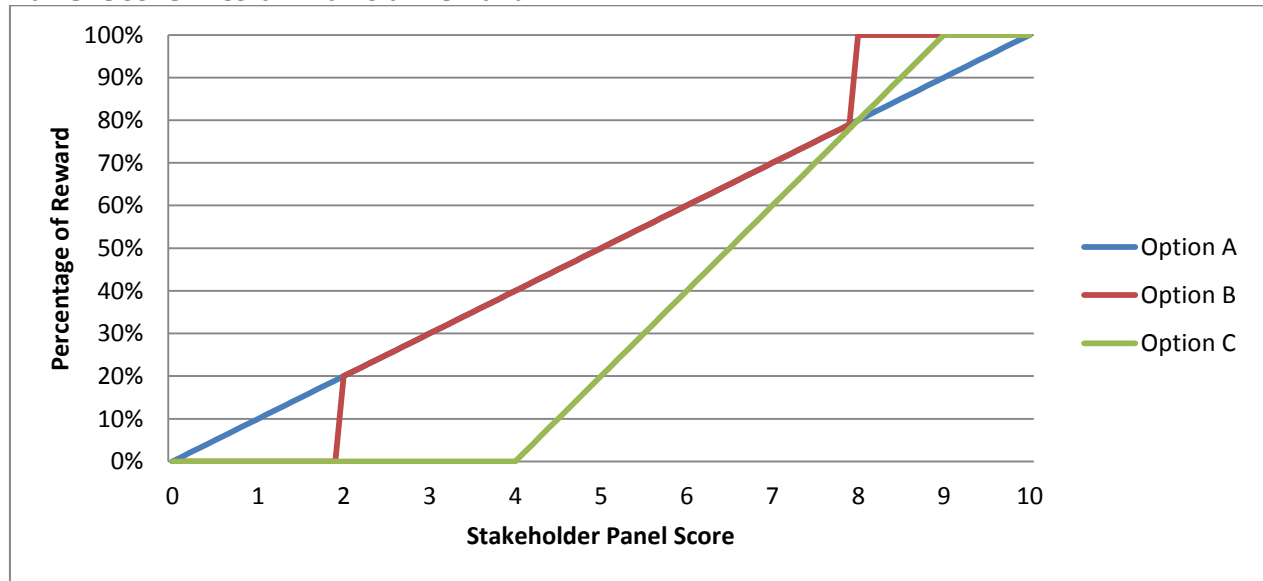
<sup>6</sup> The threshold score is the minimum overall panel score required for a licensee to earn a financial reward for their stakeholder engagement activities.

<sup>7</sup> The maximum reward score is the minimum overall panel score required for a licensee to earn their maximum financial reward exposure.

**Table 1: Potential options for converting the Stakeholder Engagement Incentive panel score into a financial reward.**

Option	Threshold Score	Maximum Reward Score	Incentive rate
A	0	10	Straight line incentive rate between the threshold and maximum Reward Score.
B	2	8	Between 2 and 7.99, the incentive rate mirrors the "Option A" incentive rate. <sup>8</sup>
C	4	9	Straight line incentive rate between the threshold and maximum Reward Score.

**Figure 1: Potential options for converting the Stakeholder Engagement Incentive Panel score into a financial reward**



Consideration of options

We are minded to support Option C.

We consider that this approach rewards good performers, does not reward weaker performers and ensures that excellent performers are able to realise 100 per cent of their incentive exposure. This approach has the advantage of being relatively simple and avoids the introduction of "cliff" points in the reward profile, where insignificantly small differences in scores result in large differences in financial reward.

We have discussed this issue informally with network companies and wider stakeholders. Of those network companies that expressed an opinion, most were minded to support Option B (or an alternative option similar to this).

Some network companies were concerned that our preferred approach could erode the value of the incentive. We disagree that these changes would erode the value of the incentive. We note that excellent performers are able to earn a larger incentive under our proposed arrangements and consider that our preferred approach provides a stronger incentive for companies to engage better with stakeholders.

Some network companies were also concerned that our preferred approach represented a significant change from the price control settlements that they had agreed. We disagree that this is a significant change. The licence does not specify how we should convert the overall panel score into a financial reward. This consultation, therefore, seeks views in order to provide clarity on these arrangements.

<sup>8</sup> The score out of 10 is converted into a percentage of the companies' overall revenue exposure

Some network companies suggested that we could take a different approach for gas and electricity, transmission and distribution, to recognise the differences between these sectors. We note that there are currently differences in performance across the sectors. However, we have deliberately chosen stakeholder and consumer experts from across a range of industries (including non-energy) to inform our assessment. We want this incentive to help us identify genuinely "good" performance, regardless of the sector that the company is operating in. We, therefore, consider that different approaches are unnecessary.

#### Questions to consider

We are keen to hear views on the following questions:

- 1. Do you consider that companies should meet a threshold level of performance before they are entitled to receive a reward? If so, what should the threshold score be and why?**
- 2. Do you consider that companies should be able to receive their maximum reward for performance above a specified level? If so, what should the maximum reward score be and why?**
- 3. What should the incentive rate be between the threshold score and the maximum reward score?**

#### Whether the electricity distribution Stakeholder Engagement Incentive should take into account price indexation?

In the electricity distribution licence, the value of the Stakeholder Engagement Incentive is specified in 2007-08 values. However, for this incentive, there is currently no mechanism in the licence to take into account inflation.

We are, therefore, also consulting on whether the Stakeholder Engagement Incentive reward amount should be inflated, using RPI, to ensure that the value of the reward remains relevant.

**We are seeking views on whether these values should be inflated using RPI.**

#### Consultation Responses

Responses should be sent to [connections@ofgem.gov.uk](mailto:connections@ofgem.gov.uk) by 8 May 2014. Unless clearly marked as confidential, responses will be published on our website.

We will review consultation responses and issue a decision in early summer 2014. We will take this decision into account when determining the value of the 2013-14 Stakeholder Engagement Incentive reward.

If you have any questions about this consultation, please email me at [connections@ofgem.gov.uk](mailto:connections@ofgem.gov.uk) or phone me on 0207 901 1861.

Yours faithfully,

**James Veaney**  
**Head of Distribution Policy**