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Dear James,

Stakeholder Engagement Incentive reward consultation

Thank you for the opportunity to respond to this consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

We have reviewed the issues highlighted by Ofgem and the options put forward in the consultation and we have identified two key concerns:

- **The overall Broad Measure of Customer Satisfaction will, in practice, not be a symmetric incentive based on how the component elements are to be calibrated, including this Stakeholder Incentive reward. It would now be very likely that rewards will outweigh penalties. The Stakeholder Engagement Incentive should therefore be viewed in the context of the overall Measure of Customer Satisfaction.**
- **All options reward networks for 'fair' performance. There should be an expectation that networks will operate at a 'fair' level as business as usual and rewards for this should not follow automatically. Networks should only be rewarded for upper quartile levels of stakeholder engagement.**

The Stakeholder Engagement Incentive should be viewed in the context of the overall Broad Measure of Customer Satisfaction to maintain the principle of a symmetric incentive

Whilst the consultation focuses solely on the Stakeholder Engagement incentive, we believe that stakeholder engagement must be viewed in the wider context of the overall Broad Measure of Customer Satisfaction (BMCS).

For DPCR5, RIIO GD1 and RIIO ED1 Ofgem have presented the BMCS as a **symmetrical** incentive as demonstrated by the table below:

Broad Measure of Customer Satisfaction (BMCS)	Maximum reward/penalty (per cent of annual base revenue)		
	DPCR5	RIIO GD1	RIIO ED1
Customer Satisfaction Survey	+0.8 / -0.5	+0.5 / -0.5	+1.0 / -1.0
Complaints Metric	-0.5	-0.5	-0.5
Stakeholder Engagement	+0.2	+0.5	+0.5
Overall BMCS	**+1.0 / -1.0**	**+1.0 / -1.0**	**+1.5 / -1.5**

We agree with this principle of a symmetrical incentive. In a competitive environment, businesses with good customer service would be expected to benefit commercially at the expense of businesses with poor customer service, by gaining market share, but not at the expense of customers. It is therefore appropriate for the BMCS arrangements to be symmetrical.

However, whilst the BMCS has been designed to be symmetrical in principle, now that the first set of performance scores for DNOs for 2012/13 is available, we do not believe this is the case in practice. The complaints metric incentive has been calibrated in such a way as to make it virtually impossible for a DNO to incur the maximum penalty. Therefore if, as stated in the consultation, Ofgem consider that the full value of the Stakeholder Engagement incentive *"should be challenging, but achievable"* if the full value of Complaints Metric penalty is not realistically achievable then the overall BMCS becomes asymmetric in practice. This would be inconsistent with the principle of Final Proposals and the RIIO ED1 Strategy and to the detriment of consumers.

DNO complaints scores for 2012/13 range from 2.6 to 15.9 with an average of 8.8 (maximum value is 100), however the incentive is calibrated such that the maximum penalty (-0.5%) would only be reached if a DNO scored 70. For 2012/13, the complaints metric incentive therefore translates to a penalty of just £1.5m out of a potential revenue exposure of £21.1m i.e. a penalty of 7% of the total exposure. Whilst the proposed RIIO ED1 mechanism is tougher, our analysis suggests that the 2012/13 DNO performance would still only represent a penalty of 32% of the total exposure for RIIO ED1 whilst under the RIIO GD1 mechanism the same level of performance would only represent 12% of the total exposure.

By contrast however, the Stakeholder Engagement scores for 2012/13 average 7.6 (out of 10) for the 5 networks which passed the minimum requirements. This translates to a stakeholder engagement reward of £5.5m out of a total potential reward of £8.5m i.e. a reward of 65% of the total exposure. The proposed RIIO ED1 mechanism increases the exposure of this element of the BMCS such that the 2012/13 performance would result in annual rewards of £15.5m (using option A).

The 2012/13 performance scores and rewards/penalties for the complaints metric and stakeholder engagement support our view that the calibration of BMCS so far has resulted in an asymmetric incentive. This consultation is an opportunity to modify the method of calculating Stakeholder Engagement rewards to ensure that the principle of a symmetric BMCS is maintained e.g. networks should be as likely to receive the maximum reward for Stakeholder Engagement as they are to receive the maximum penalty for the Complaints Metric. We are concerned that otherwise customers are effectively being asked to fund improvements in customer service which they have a legitimate expectation to receive.

Networks should only be rewarded for upper quartile levels of stakeholder engagement

We do not consider it appropriate for networks to receive rewards for any score given by the Panel (option A). Clearly it is inappropriate to reward poor performers. We consider that a network should only be rewarded if the score awarded by the Panel is both:

- Upper Quartile
- At least six i.e. at least 'fair' as described in the consultation

Our rationale for such an approach is to mitigate the risk of consumers funding excess rewards. The Panel assessment of stakeholder assessment is qualitative in nature. This means the most instructive conclusions to be drawn from the Panel scores will be the comparison between networks. The individual scores could be subject to bias (i.e. all companies scored too harshly or too generously) which would be difficult to identify. However, the relative performance between networks should be far more reliable.

Limiting rewards only to upper quartile performers mitigates this risk to some extent, as it relies on relative performance, whilst still providing a strong incentive on networks to improve stakeholder engagement. In the competitive environment, businesses are rewarded for their level of customer service relative to their competitors.

We regard to the transmission companies, it is even more appropriate to limit rewards to upper quartile performance since there is no equivalent complaints metric to ensure the symmetry of the customer satisfaction arrangements. As explained above, we believe it is appropriate that the customer satisfaction arrangements should be symmetrical and since this is not the case for the transmission companies, we consider therefore that they should only receive a reward if their performance is upper quartile, noting that performance would probably need to be measured against distribution performance scores.

Consultation 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?

It is clearly inappropriate to reward poor performance. We also consider it inappropriate to reward 'average' performance. Therefore, we consider that a minimum threshold level of performance of 6 should be required before any network should be considered for a reward. However, we also consider there is a risk of consumers funding excess rewards to networks, potentially due to the possibility of scoring bias. For these reasons, we believe that only upper quartile performers should be rewarded, subject to the requirement that upper quartile must also be at least 6. We consider that limiting rewards to upper quartile performance would also better maintain the intended symmetrical nature of the BMCS for distribution networks.

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?

We disagree with the suggestion that due to its qualitative nature it may be unlikely that the Panel awards a score of 10 out of 10, especially given the best performing DNO has achieved a score of 8.4 in the first year of operation. Setting a level below 10 for the maximum reward would remove the incentive for the best performers to seek to continue to improve. This is not appropriate. The maximum reward should be achieved by a performance score of 10.

3. What should the incentive rate be between the threshold score and the maximum reward score?

As per our responses above we believe that the minimum required score before a network should be considered for any reward should be set at 6, and the score at which a network should receive the maximum reward should be 10. We therefore suggest a straight line incentive rate between 6 and 10 i.e incentive rate = revenue exposure / (10 – 6) (i.e. max threshold, 10 – min threshold, 6)

We therefore suggest an alternative proposal for the Stakeholder Engagement reward as follows:

- Networks must receive scores above 6.0 to be considered for any reward
- Only upper quartile performers will receive a reward
- Incentive rate should be set to produce a straight line reward between the minimum score, 6 and the maximum score, 10.

We hope you find our comments helpful. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning
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