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Dear Mr Veaney

Stakeholder Engagement Incentive Consultation

This submission was prepared by the Consumer Futures team within Citizens Advice. It has statutory responsibilities to represent the interests of energy consumers in Great Britain. We welcome the opportunity to provide a submission on the design of the Stakeholder Engagement Incentive Reward (SI).

The strengthened SI is a key feature of the Revenue = Incentives + Innovation + Outputs (RIIO) price control framework. It provides an additional incentive for utilities that have traditionally been inward looking and asset orientated to become more customer focused. That consumer vulnerability has been placed at the heart of the SI is a particularly welcome development.

In this submission we comment on the methodology proposed by Ofgem to convert the assessments of the Independent Panel into financial rewards under the SI. With the RIIO-ED1 process close to being finalised, and RIIO settlements already in place for gas distribution and transmission, attention must turn to delivery and accountability. Getting the governance arrangements for the SI right is a critical part of this accountability agenda.

Summary

Ofgem's review of the governance arrangements for the SI is timely given the outcomes of the Pilot SI suggest that the assessment process could be better calibrated to ensure networks are appropriately rewarded for the quality of their engagement with their stakeholders. We therefore understand why Ofgem is considering a more sophisticated methodology to convert the assessment of the Independent Panel into a financial reward. But for the reasons we outline in the submission below, we do not think that this addresses the main issue for the governance of the SI, and may in fact, have unintended consequences that could undermine the efficient administration of the incentive. We favour the retention of the linear conversion methodology outlined by Ofgem as Option A in the consultation document, but with a stronger focus on best practice by benchmarking the performance of the networks against that in other sectors.

Detailed Comments

Our starting point for considering the design of the governance arrangements for the SI is the fact that the assessment of stakeholder engagement performance is one that is inherently relative in nature. The systems the networks implement, and the resulting outcomes can only be judged against what other organisations are doing in a similar space: what is considered 'best practice'.

So having a clear definition what constitutes 'best practice' in the context of RIIO price controls is essential. Our view is that it must reflect the fact that effective engagement with customers and other stakeholders is core business for networks for which they receive base revenue. Additionally, it should not be overlooked that there is upside here too: networks stand to benefit from building positive relationships with their stakeholders by for example, being better able to better forecast load growth, minimising complaints, and providing a more fulfilling workplace for its employees. The purpose of the SI must be to reward networks for going beyond this 'acceptable' level of performance to deliver services and build relationships in a manner that is 'best practice'. The challenge for designing governance arrangements for the SI is for it to be sufficiently targeted to minimise the risk of networks being over-rewarded for 'run of the mill' stakeholder engagement.

We think the key to mitigating this risk is by assessing the network's performance against that in other comparable sectors; not simply by reference to the performance of one network in relation to another. Although we accept that the nature of their assets and the services they provide is somewhat unique, making benchmarking at times challenging, stakeholder engagement is a function that is readily comparable across sectors. How well networks manage call centres, how complaints are dealt with and vulnerable customers supported are not functions specific to networks. We therefore support Ofgem's initiative to form an Independent Panel comprising of people with experience across a range of sectors that can bring this broader view to the assessment process.

But how the Independent Panel is applying its perspective in the assessment process is not clear from the results of the SI to date. For example, no reference is made to how the performance of the networks compared to that in other sectors in the Report of the Gas Distribution Network Stakeholder Engagement Incentive Trial for 2012/13, the discussion being limited to how they fared against each other. This is also the case in the reports on the Electricity Stakeholder Engagement Scheme for 2011-12 and 2012-13. We therefore see merit in revisiting the Guidance Document and the Scorecard to make it absolutely clear that the relevant benchmark for the Independent Panel is stakeholder engagement performance against this broader standard.

We also think there is a need to amend the qualitative scale on the Scorecard that currently has performance ranked in ascending order: 'Weak', 'Average', 'Fair', 'Good', 'Excellent'. In addition to explicitly anchoring these terms to a broader benchmark, we think they should be adjusted up. We are concerned that having the starting point set at 'weak' could give the Independent Panel the impression that for the networks are entitled to reward for performance that barely meets minimum standards. Our view is that this would be inconsistent with the objectives of the SI being only to reward performance that is 'best practice'. One way of overcoming this may be, for example, to set the scale in ascending order from 'average' to 'excellent', with appropriate incremental descriptors between.

The kinked conversion methodologies that Ofgem proposes in the consultation document in Options B and C is an alternative approach to the problem of over-reward but there is a risk that it will distort the way the Independent Panel evaluates performance. In addition to essentially fettering the independence of the Independent Panel, we think it may introduce a bias into the way they approach evaluation, increasing the likelihood it will award scores within the rewards range (i.e. 4-9 for Option C) than may otherwise be the case. Indeed the results of the pilots suggest to us that it may not significantly change the outcome, given the Independent Panel has tended to award score clustered midway on the 1-10 scale. For example, the report on the results of the 2012/13 Gas Distribution SI Pilot shows that the four networks received scores of between 5.25 and 6.4 out of ten – all within the rewards range for Options A, B and C. The lowest score was awarded to a network that failed to meet the minimum requirements, and other than it being the Pilot and waved through to experience the process, would not have been eligible to be assessed by the Independent Panel for reward. This pattern is also evident in the Electricity Stakeholder Engagement Scheme. In 2013-13 for example, scores ranged from 6.85 to 8.4, with one network not making it through to the Independent Panel assessment stage. We therefore see no reason to move away from the linear approach in Option A that is easy to understand and minimises the risk of introducing a bias into the evaluation process.

We do not accept the argument that the separation of the evaluation by the Independent Panel from the mechanistic determination of financial reward will reduce this risk: the Independent Panel will be very aware of the financial implications of their judgement. Indeed we think the premise for separating the evaluation from financial materiality is flawed: the quantum of financial reward the networks receive as part of their base revenue and the SI must inform the evaluation of performance. That is, how can the Independent Panel make a judgement about the level of stakeholder engagement the network should be delivering if it does not understand the resources available to the network to deliver it? Or have an appreciation for the quantum of the reward available to the network for performing at a level that is beyond ‘best practice’? Our view therefore is that not only should the financial and evaluation elements of the SI assessment process remain as one, Ofgem should (if it doesn’t already) brief the Independent Panel on the network’s key financial metrics to ensure their performance can be properly contextualised.

We think Ofgem can guard against over-reward under Option A by ensuring it strictly exercises its right not to refer networks to the Independent Panel stage of the process that do not exhibit at least an average level of performance. In making this determination, Ofgem should have regard not just to the networks SI submission, but also to its performance on the other elements of the BMCS. A network that for example, failed to meet its complaints targets or communicate effectively with its customers during a storm – as we saw during the 2013 Christmas storms – would need to provide a compelling case to be considered for award under the SI.

This also goes to the broader point that more clarity is needed from Ofgem and the networks on how the SI fits into the overall RIIO framework. Although the Strategy Document states that the SI is an upside only reward, comprising a maximum 0.5 per cent of base revenue, it is not clear what this means for consumers in terms of pounds and pence – both at an aggregate level for their network and its impact of the average electricity bill. It is also difficult to understand how the SI interacts with other revenue streams. For example, consumers need to have confidence that a network that performed poorly under the complaints component of the Broad Measure of Customer Satisfaction (BMCS) was not rewarded under the SI: logically, performance under these measures should be correlated. There may be merit in Ofgem establishing an explicit link between performance on the other elements of the BMCS and the SI. That is, if a network fails to meet its complaints target, then it may be ineligible for reward under the SI.

This lack of a global view of the network revenue under RIIO is significant barrier to consumers and other stakeholders making informed judgements about value for money. Most stakeholders are not in a position to review thousands of pages of business plans and guidance material to reach an understanding of the net effect of these incentive and penalty measures. It would be useful therefore if Ofgem could produce a simple graphical or tabular summary of the range of returns each network may accrue in aggregate over the period of a RIIO price control to make this task achievable.

Finally, given the SI is a relatively novel incentive that is pushing the networks into new areas, there would appear to be merit in revisiting the governance arrangements for it as part of the mid-cycle review for RIIO price controls to see if it should be recalibrated in light of accumulated experience.

Thank you for the opportunity to make this submission, please do not hesitate to make contact with me if you would like to discuss it further.

Yours sincerely

C Alexander.

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