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Dear James

Thank you for the opportunity to review and comment on 'Ofgem's proposals on the changes to the Stakeholder Engagement Incentive Scheme reward consultation' published on 27th March 2014. We recognise Ofgem's concerns around potentially rewarding poor performers and conversely that good performers should be able to access the full reward.

Whilst we agree that this incentive should be challenging but achievable, we believe that any changes should maintain the incentive bandwidth and represents a fair opportunity for network companies to be recognised and rewarded for their performance. This is what we believe we signed-up to at the point of Final Proposals. We believe that Option C as it currently stands is therefore not in the spirit of this agreement. In line with the RIIO framework, we would also advocate that any changes to the scoring mechanism should continue to drive the right behaviours and deliver a fair balance of risk and reward.

We are mindful that the existing licence condition enables Ofgem to change the parameters of the scoring mechanism at any point during the 8 year control. During development of the incentive and throughout industry discussions, it was believed that the main purpose of enabling the stakeholder engagement incentive guidance to be updated 'from time to time' was to facilitate changes to the scoring categories and weightings to align with stakeholders changing requirements and new and emerging industry issues. We note however, it has been used to make fundamental changes to the scoring mechanism. For networks to have certainty, and in line with the RIIO principles, we believe that that the outcome of this review needs to be set for 8 years.

Our response to your specific questions is made below:

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?

We understand Ofgem's concerns that companies should not be rewarded for poor performance, but also believe that an appropriate balance of risk and reward is essential to fairly incentivise network companies for their performance and to drive the right behaviours. The level of reward at the entry threshold therefore needs to ensure appropriate balance of risk and reward. We believe that Option B, which provides for a symmetrical incentive, would best facilitate this fair outcome with an entry threshold score of 2.

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 recognise that, under a panel based reward incentive, it will be difficult for companies to achieve the maximum reward. As stated above, we believe that Option B best facilitates an appropriate balance of risk and reward and will incentivise companies to drive the right behaviours to the benefit of customers and stakeholders. We agree that the maximum reward score should be set at 8, as consistently scoring 8 and above each year will be challenging, given that stakeholder's expectations will increase over time and network companies will have to work harder to maintain this high level of performance.

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

We believe that any change to the incentive should not remove the bandwidth or dampen the incentive properties for companies whose performance are above the threshold but may not be at the top end of the incentive. It is clear that Option C, as it currently stands, disadvantages anyone below a score of 8. These companies will be delivering positive outcomes for their stakeholders and should be rewarded accordingly.

We therefore believe that a straight line reward should be made between the threshold and the maximum. Although we do not support Option C in its current form, if Option C were to be taken forward then it should be adjusted so that a company who scores below 4 out of 10 would receive no reward, but who scores 4 out of 10 would earn 40% of the reward and so on until it reached maximum reward at a score of 9 or above. Whilst being challenging, this would provide for a fairer balance of risk and reward than the existing Option C, and would not reduce the incentive properties for companies delivering positive outcomes for their stakeholders.

Therefore, in either Option B (which we believe best balances risk and reward) and Option C, the incentive rate should start at the same level as the entry level, for example 20% in Option B and 40% in Option C. As mentioned previously we believe that the outcome of this review should provide for a stable framework for the full 8 year RIIO term to provide a clear purpose and platform for companies to deliver the best outcome for their stakeholders.

If you would like to discuss our response further, please contact Tracy Hine (Distribution) on 07885 775624 or by email to tracy.hine@nationalgrid.com, or Vicky Higgin (Transmission) on 07773 821162 or by email to victoria.higgin@nationalgrid.com

We look forward to submitting our stakeholder engagement reports under the scheme on 30th May.

Yours sincerely

[By e-mail]

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