

DNOs, GDNs, TOs and other interested parties

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Stakeholder Engagement Incentive: level of reward

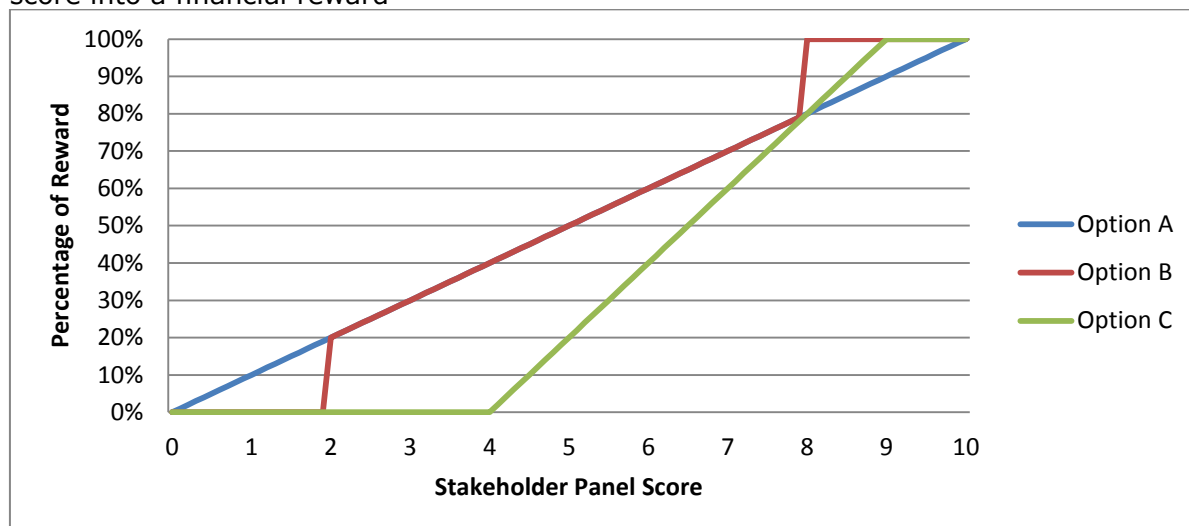
The Stakeholder Engagement Incentive encourages regulated network companies to engage effectively with a wide range of stakeholders and use the outputs from this process to inform how they plan and run their businesses.

Under this incentive, a network company may receive a financial reward depending on the quality of its stakeholder engagement. An independent panel of consumer and stakeholder engagement experts ('the Panel') assess performance out of 10.

Consultation

We did not specify how the overall panel score is converted into a financial reward in any of the relevant licence conditions.¹ On 27 March 2014 we consulted on how the Panel's score should be converted into a financial reward for all network companies.² We sought to find a solution which did not reward poor performers and ensured that the full value of the incentive was challenging, but achievable. Our three proposed options are outlined below:

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



¹ Special Condition 1E (Incentive adjustment in respect of the Broad Measure of Customer Satisfaction) of the gas transporter licence (for gas distribution), Special Condition 2C (Stakeholder Satisfaction Output) of the gas transporter licence (for gas transmission) or Special Condition 3D (Stakeholder Satisfaction Output) of the electricity transmission licence

² <https://www.ofgem.gov.uk/ofgem-publications/86818/stakeholderengagementincentiverewardconsultation27march2014.pdf>

We also sought views on whether the electricity distribution Stakeholder Engagement Incentive should be inflated using the Retail Price Index.

Responses

We received 13 responses to our consultation. We received responses from gas and electricity, transmission and distribution companies. We also received responses from two suppliers and from Citizens Advice. All responses can be found on our website.³ The respondents supported different approaches to convert the Panel score into a financial reward. We summarise the positions below:

Respondent	Threshold Score	Maximum Reward Score	Incentive Rate
British Gas	6 and upper quartile	10	Straight line between 6 and 10
EDF	4	9	Straight line between 4 and 9
Western Power Distribution	4	9	Straight line between 4 and 9
Northern Gas Networks	4	9	Straight line between 4 and 9
UK Power Networks	3	8	Straight line between 3 and 8
Electricity North West	3	8	Straight line between 3 and 8
Scottish Power Energy Networks	2	9	Straight line between 2 and 9
Northern Powergrid	2	8	Maintain existing incentive rate ⁴
National Grid	2	8	Maintain existing incentive rate
Scotia Gas Networks	2	8	Maintain existing incentive rate
Scottish and Southern Energy Power Distribution	2	8	Maintain existing incentive rate
Wales and West Utilities	2	8	Maintain existing incentive rate
Citizens Advice	0 ⁵	10	Straight line between 0 and 10

Some stakeholders also raised additional comments on the Stakeholder Engagement Incentive that they wanted us to consider.

A summary of consultation responses and our response to the points raised can be found in Appendix 1 to this letter.

Of those respondents who commented, all considered that the electricity distribution Stakeholder Engagement Incentive should take into account price indexation, to ensure that the incentive values remain relevant.

Decision

After considering the responses received to our consultation, we have decided to introduce a threshold score of 4 out of 10 and a maximum reward score of 9 out of 10, with a straight line incentive rate between these two values. We consider that this approach will reward good performers, will not reward weaker performers, and will ensure that excellent performers are able to realise 100 per cent of their incentive exposure.

³ <https://www.ofgem.gov.uk/publications-and-updates/stakeholder-engagement-incentive-reward-consultation>

⁴ Where a score of 5 out of 10 would receive 50 per cent of the total reward.

⁵ Citizens Advice preferred approach would redefine zero as “average”, rather than weak.

We will also take into account price indexation for any electricity distribution Stakeholder Engagement Incentive rewards.

We will take this decision into account this summer, when determining the value of the 2013-14 Stakeholder Engagement Incentive reward.

If you have any questions on our decision then please contact us at connections@ofgem.gov.uk.

Yours faithfully,

A handwritten signature in blue ink that reads "Andy Burgess".

Andy Burgess
Associate Partner, Transmission and Distribution Policy

Appendix 1 – Summary of comments raised in the consultation and our responses

Question 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?

Respondents' comments

Those respondents who supported our “minded to” position considered that weaker performers should not be rewarded and that a threshold score of 4 was therefore appropriate.

Several respondents considered that a threshold score of four out of 10 was too high. These respondents considered that the minimum requirements already stopped poor performers from being rewarded. These respondents were also concerned that setting the threshold score too high might erode the incentive value and discourage network companies from participating in the scheme. They suggested moving the threshold score to two or three out of 10.

To mitigate against consumers funding excess rewards, one respondent consider that we should only reward companies if they scored above six out of 10 and were in the upper industry quartile. They noted that in a competitive environment businesses were rewarded for their level of customer service relative to their competitors.

Our views

We disagree that setting the threshold score at four out of 10 is too high. We expect network companies to engage effectively with their stakeholders. We note that the several companies scored significantly higher than this last year. While we acknowledge that transmission companies generally performed at a lower level in the trial year, we do not want to differentiate between types of companies in the reward structure, although we consider that the Panel should be aware of the differing contexts between distribution and transmission. We consider that the approach of a single threshold of four out of 10 provides a stronger incentive for companies to perform well.

We also do not support only rewarding upper quartile performers. Fixed threshold scores will make it easier for network companies to build a business case for new investment in order to improve service. To maximise value for consumers, we want to encourage collaboration and the sharing of best practice between companies. We therefore do not support an alternative, competitive approach which may disincentivise this behaviour.

We note that several network companies scored below four out of 10 last year. We therefore consider that four out of 10 is a challenging, but fair, threshold level of performance.

Question 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?

Respondents' comments

Those respondents who supported our “minded to” position believed that the Panel was unlikely to award 10 out of 10. They considered that a challenging, but achievable, maximum reward score of nine out of 10 was therefore more appropriate.

Several respondents considered that a maximum reward score of nine was too high, on the basis that, as the incentive progressed, expectations would increase and it would be harder to maintain a score of eight out of 10. These respondents considered that eight out of 10 would be an appropriate maximum reward score.

One respondent disagreed that the Panel was unlikely to give a score of 10 out of 10 and considered that setting the bar lower would remove the incentive for best performers to continue to improve.

Our views

Given the qualitative nature of the assessment, we consider that it may be unlikely that a score of 10 out of 10 would be achieved. We consider it extremely challenging, but achievable, for a network company to be able to achieve a score of nine out of 10 and we envisage little substantive difference in performance between the two scores. We therefore consider that a maximum reward score of nine out of 10 is appropriate.

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

Respondents' comments

The majority of respondents supported a straight line incentive between the threshold score and the maximum reward score that they proposed. These respondents noted that this was simple and would avoid the introduction of "cliff-points" where marginal differences in score result in large financial differences.

Other respondents supported option B. Under this approach, a score of four out of 10 would still receive 40 per cent of its reward exposure. These respondents considered that this would maintain the value of the incentive.

Our views

We continue to support a straight line incentive between the threshold score and maximum reward score, to keep the approach simple and to avoid the introduction of "cliff points".

Question 4: We are seeking views on whether these values should be inflated using RPI.

Respondents' comments

Of the respondents who commented, all considered that the electricity distribution Stakeholder Engagement Incentive should take into account price indexation, to ensure that the incentive values remain relevant. Two respondents suggested applying a retrospective adjustment to be applied to the 2012-13 electricity distribution Stakeholder Engagement Incentive reward.

Our views

We agree that the electricity distribution should take into account price indexation, to ensure that the value of the incentive remains relevant.

We consider that it would undesirable and inconsistent with RIIO retrospectively to amend previous incentive adjustments based on new principles. We therefore do not intend to make retrospective adjustments to the 2012-13 electricity distribution Stakeholder Engagement Incentive Reward.

Other

Benchmark performance against other sectors

Citizens Advice considered that the Panel needed to benchmark performance against other sectors, to ensure that networks were not over-rewarded for average levels of

performance. Another respondent suggested that performance should not be assessed against other sectors, because this might not take into account sector specific issues.

Our external Stakeholder Engagement Panel intentionally draws upon expertise from outside of the industry. This helps ensure that performance is weighed against other sectors. We consider that this is appropriate to ensure that networks are driving to meet the standards of performance set in other competitive industries. We consider that through appropriate briefing this approach can also take into account sector specific issues.

Proposed approach may distort results

Citizens Advice considered that our proposed approach (of only rewarding scores above a threshold level) might distort the Panel scores, so that the Panel would always score network companies above the threshold score.

We consider it important that DNOs are not rewarded for poor performance and disagree that our proposed approach might distort the Panel's score. We ask the Panel to concentrate on assessing the networks against a set of criteria. If the Panel considers that a company has performed poorly then there is no obvious incentive for them to score above four out of 10.

Panel briefing

Citizens Advice considered that the Panel should be briefed on the relative size of each organisation (eg each companies' base revenue), so that they can properly evaluate the level of resource that each company should be devoting to engaging with stakeholders.

Panel members will be briefed on the relative size of each network company. However, the size of a company can present both challenges and opportunities. It is also only one factor which may affect the Panel's overall assessment of performance. Other factors may include the type of network company, relevant issues, regions, stakeholder types or outcomes. We therefore do not consider that this should form a central part of the Panel's assessment.

Financial impact of our decision

Citizens Advice also considered that we should publish additional information on the financial impact of this incentive for consumers (ie at an aggregate level and on the average electricity bill), to help stakeholders understand the net effect of these incentives.

We commit to providing information on the results of the Stakeholder Engagement Incentive. We are currently reviewing our approach to reporting network companies' performance generally.

Performance in other areas

British Gas and Citizens Advice considered that the Stakeholder Engagement Incentive should take into account performance under other elements of the Broad Measure of Customer Service for distribution companies. Citizens Advice suggested that if a company performed poorly under one part of the incentive, then they should not be rewarded under the Stakeholder Engagement Incentive. British Gas suggested that it was easier to earn rewards under the Stakeholder Engagement Incentive than earn penalties under the Complaints Metric.

We note that the Broad Measure of Customer Service contains three separate incentives and we consider that we have set challenging targets under each incentive. For example, we have significantly tightened the maximum penalty score for the RIIO-ED1 Complaints Metric. We also consider that handling complaints is different to engaging with stakeholders. We are concerned that linking performance between these incentives could result in companies receiving double rewards/penalties. We therefore consider it

appropriate that complaint handling and stakeholder engagement are assessed, and incentivised, separately.

Risk and regulatory certainty

National Grid suggested that our proposed changes did not ensure an appropriate balance of risk and reward and were not in the spirit of what was agreed in our RIIO-T1 Final Proposals. Our RIIO-T1 Final Proposals did not specify how the panel score should be converted into a financial reward. We do not therefore consider that we are changing the price control settlement. We do however recognise the need to provide network companies with certainty and clarity about the incentive.

Several respondents suggested fixing our decision for the period of the price control. We agree that there are benefits to regulatory certainty (eg so that networks can help justify investment in stakeholder engagement) and we currently do not intend to revise this decision during the control period.