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Dear James,

**Stakeholder Engagement Incentive reward consultation**

We thank you for the opportunity to comment on the proposed Stakeholder Engagement Incentive Reward for network companies.

We would like to highlight that SPEN, being both a DNO and TSO, are in a different position to the majority of DNOs and GDNs, and we therefore approach this subject matter from both a distribution and transmission perspective.

The RIIO-T1 plans for Transmission network companies have already been agreed by Ofgem and forecasts have already been based on an expectation of a straight-line reward profile from 0 to 10 and, in support of regulatory transparency, we do not believe that we should depart from the reward process adopted for the 2012/13 year.

Our understanding of the Stakeholder Incentive was that network operators that met the minimum requirements would be eligible for a financial reward under the incentive mechanism. Overall, we are concerned that Ofgem's overriding proposal is an approach which could erode the value of this important incentive. We are also mindful that this is a two stage reward process in which there is a gate entry that already ensures a minimum level has been achieved, the introduction of a minimum threshold effectively adds an additional layer of protection for Ofgem and ultimately consumers. That said, we are sympathetic to Ofgem's apprehension to provide low scoring companies with a financial reward and our proposal below provides more of a balanced response to thresholds and provides the right behavioural drives for all network companies.

We expect that it will be increasingly difficult to improve scores over the RIIO-ED1/RIIO-T1 period. This expectation of increasing standards is also inferred by Ofgem in the recent guidance decision for this scheme where Ofgem indicated that "our assessment of minimum criteria will take into account changes over time". Our expectation is that we will need to continuously improve just to

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maintain the levels achieved to date. We note that the score of the best performing DNO company actually reduced from the previous year; even though they had made improvements to their stakeholder engagement.

We also note that Ofgem are keen to have an identical approach in determining the reward for Transmission & Distribution network companies. However, evidence of the scores from last year show a significant difference (distribution scores ranging from 5 to 7 whilst the transmission scores ranged from 3 to 3.4) and we maintain that this difference in scoring demonstrated that the panel did not have sufficient understanding of the differences between the customers and stakeholders relevant to Transmission and Distribution, respectively. It is important that Ofgem seek to provide the panel with sufficient context in order for the panel to make the distinction between the two, especially with the planned introduction of a minimum threshold.

In response to each of the questions raised in the consultation:

***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?***

As this is a two stage reward process in which there is a gate entry that already ensures a minimum level has been achieved, the introduction of a minimum threshold effectively adds an additional layer of protection for Ofgem and ultimately consumers. We also believe that the minimum threshold should not be used as a means of undermining the incentive that this scheme sought to provide; the encouragement of good quality stakeholder engagement.

We agree with Ofgem on the point that very low scoring companies should not receive financial rewards which is why we could support a minimum threshold of 2, where a score of two would receive no reward but any score higher than this would attract an increasing level of reward.

***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?***

Companies have previously argued that the full value of this incentive is extremely unlikely to be realised as it would necessitate a score of 10 out of 10. We agree with this and support the idea of having a maximum reward threshold alongside the introduction of minimum threshold to offset the implied benefit. We would propose that maximum reward should be available from a score of 9 provided this is accompanied by a minimum threshold of 2.

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

We agree with Ofgem that a rate as shown in 'Option B' could create an inappropriate 'cliff edge' with minor changes in scores attracting significant changes in reward.

The 'Option C' proposal (straight line from 5 to 9) is too much of a departure from what was expected at the time RIIO-T1 was agreed and we would have difficulty supporting a minimum higher than 2 at this point, given our concerns about the panel appreciating the differences between transmission and distribution.

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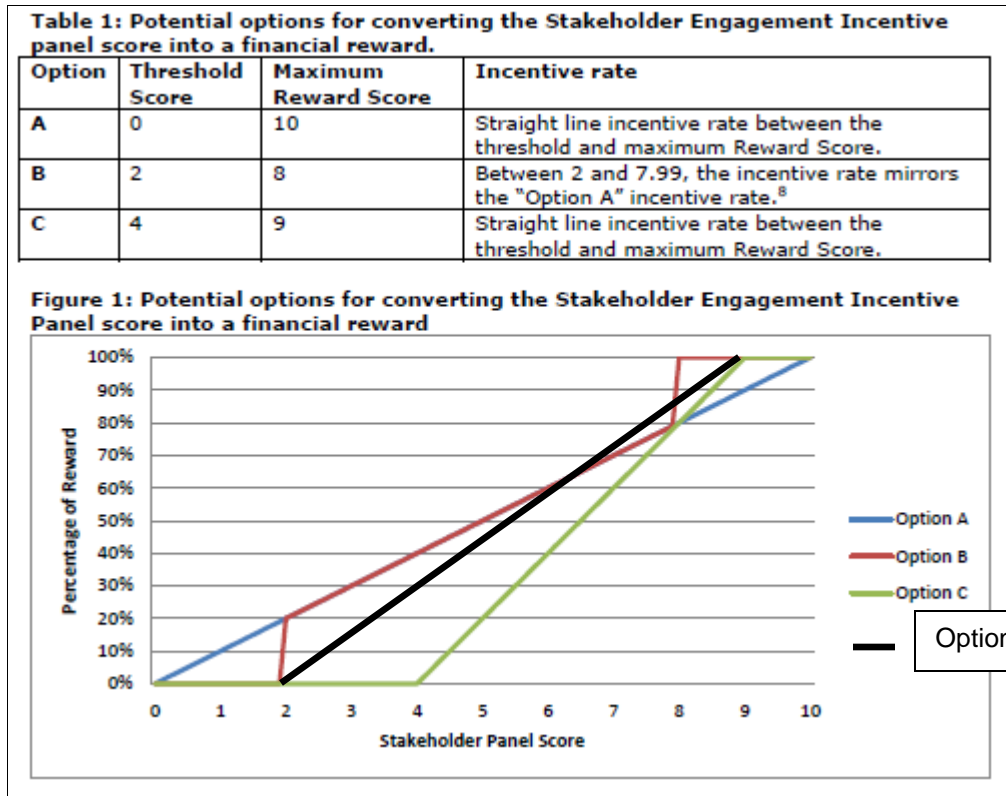
We would support an incentive rate that is a straight line between the threshold score and the maximum reward score. Our proposal 'Option D' has a threshold score of 2 and a maximum reward score of 9 with a straight-line in between.

Option	Threshold Score	Maximum reward score	Incentive rate
D	2	9	Straight line incentive between the threshold and the maximum reward

Our proposal has a steeper incentive rate than Option A and therefore provides a stronger incentive for network company improvements than was previously anticipated.

Our Option D still results in an overall erosion of the value of the incentive as the size of the reduction area is larger than the increase but is more appropriately balanced than in Option C.

Extract from Ofgem consultation with the addition of our 'Option D'



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

Yes, we believe that the values for the incentive should be inflated using RPI as the value of the incentive is set out in 2007-08 prices. It would be inconsistent with other incentives to have a reduction in incentive strength.

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We look forward to working with the Ofgem team to help shape this reward process.

Please do not hesitate to contact me should you have any queries.

Yours sincerely,

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