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27 July 2015

Dear Kersti,

Consultation on values within the stakeholder satisfaction output arrangements (electricity transmission licence, special condition 3D)

Scottish Hydro Electricity Transmission plc (SHE Transmission) welcomes the opportunity to respond to the above consultation. Whilst we appreciate Ofgem moving towards concluding on these matters, there are three areas of significant concern to us with the current proposals:

1. ***Timing**:* This consultation comes almost four months into year 3 of RIIO-T1 and, if Ofgem wish to amend licence condition 3D to enable the maximum possible reward, there will be a further statutory consultation of approximately 3 months meaning much of the financial year will have passed by the time these changes come into effect. We are therefore are strongly opposed to any changes to the values or the licence conditions for year 3. Nevertheless, we remain committed to working with Ofgem to ensure any changes can be fully factored into our planning for year 4.

2. ***Baselines that disallow the maximum achievable reward:*** We do not believe it is appropriate for a baseline to disallow the maximum reward, but enable the maximum penalty and we understand this is Ofgem's view. However, the proposed baselines of 7.4 for the survey and 84% for KPIs would do just that and we cannot support any change until we have agreed between us how the licence may be modified to give effect to this principle.

3. ***Years 1 and 2 performance defined as "business as usual":*** SHE Transmission has set a high standard early in RIIO-T1, which we intend to maintain. We do not agree that this should be considered the 'normal' level of service and, as such, believe it is not a suitable basis for the baseline. To do so will reduce the incentive to improve. Furthermore, we believe it wholly inappropriate to use the survey scores from other Transmission Owners to set our baseline.

We discuss each of these points in more detail in the following pages.

Timing

The determination of values in this incentive is intended to influence organisational behaviour. This proposal comes four months into year 3, when our stakeholder engagement strategy has been put into practice. We therefore contend that it is neither appropriate nor acceptable to judge our stakeholder engagement performance against a baseline applied retrospectively for this.

We are mindful that Ofgem reserve the right to revisit these values for years 5 to 8, presumably when the performance for years 1 to 3 is known and year 4 can be forecast. Two data points of performance at the original baseline, and a further two data points at this proposed baseline (applied partly in retrospect) is still not sufficient to assess whether this incentive is working as intended.

We also have to consider the timing of the statutory consultation to enable the maximum achievable reward. This requires a further three months before coming into effect, which if applied to year 3 is another more substantive change made retrospectively.

We believe that, as a minimum, the first three years of RIIO-T1 should continue as originally agreed. If Ofgem believes a review of later years is required then it will have the benefit of at least three years of stable conditions with which to decide what effects the baselines and the gradations between the "cap and collar" are having.

Baselines that disallow the maximum achievable reward

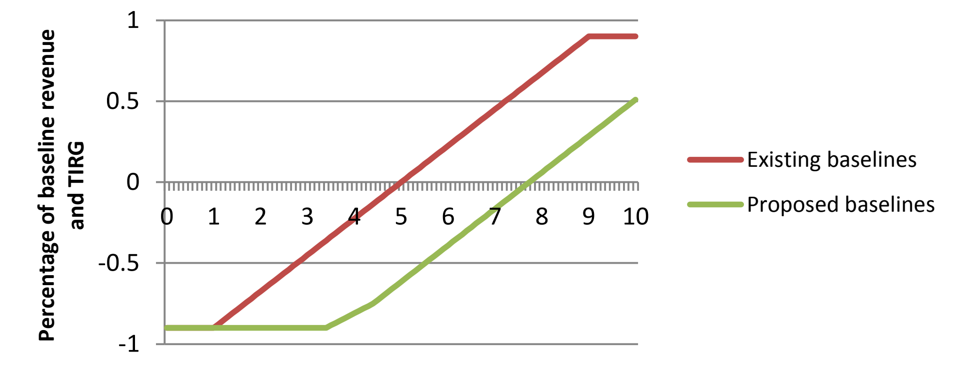
If Ofgem wish to change the baselines without enabling the maximum reward, then we believe that would contradict the basis of this incentive, as stated in the consultation:

"We consider that the baseline values should be defined so as to stretch and incentivise/reward performance in this area, beyond business as usual, whilst ensuring that under-performance is not rewarded."

We are fully supportive of these aims. But following our strong performance in the first two years, these proposals would leave SHE Transmission with the most exacting baselines of all three participating TOs: the highest KPI baseline and a survey baseline which presently offers no opportunity to reach the maximum reward.

Figure 1 overleaf compares the reward/penalty profile of the existing and proposed baselines and weightings, with the external assurance element removed. Should SHE Transmission achieve a highly improbable perfect score in both the survey and KPIs we would qualify for 0.51% reward. However, if we were to meet the original baseline, 5 and 50%, we would incur a 0.62% penalty.

Fig 1: Reward/Penalty Profile of Existing and Proposed Baselines with external assurance removed



Therefore rather than incentivising or rewarding performance, these proposals introduce a higher risk of penalty for a stronger performance, again with no commensurate upside. This disproportionate risk would remain for at least years 3 and 4, but possibly up to year 8. This is wholly unacceptable, and sets a concerning precedent for other mechanisms in the price control. The incentive was designed to foster high performance; these proposals introduce a direct relationship between high performance and high risk.

We believe the stakeholder satisfaction incentives have been successful from year one, driving improvement in Transmission Owners' approach to stakeholder service. We are proud of our performance in the first two years, we have set a high standard early on and we have improved stakeholder satisfaction levels from year one to year two. We do not believe our performance should be considered the 'normal' level of service and discuss this further below.

Furthermore, we believe it wholly inappropriate to use the survey scores from other Transmission Owners to set our baseline; we are focused on improving our standards relative to how stakeholders view our performance. Stakeholders' views of other Transmission Owners are likely to be very different and bringing that into our baseline could adversely impact how we seek to improve our stakeholder performance.

Years 1 and 2 performance defined as "business as usual"

It is our view that choosing the first two years' performance data as "business as usual" is wrong. These scores were achieved under a licenced incentive to improve performance and we did just that. In our Business Plan, we noted that we foster strong relationships with our stakeholders. We feel this was echoed in "*RIIO-T1: Final Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd"* published in April 2012, where Ofgem noted:

"We welcome the strong level of support for fast-tracking the plans of the Scottish TOs. We note that more respondents commented in support of SHETL's suitability for fast-tracking."- Section 2.8 and

"Most stakeholders were very enthusiastic about the companies' engagement processes in developing their business plans. In particular, seven civil engineering and equipment service providers said that the transparency of SHETL's business plans allowed them to plan their recruitment and training needs, identify innovative solutions to challenges and to adopt a competitive price strategy which would result in cost efficiencies for SHETL." – Section 2.11

Whilst comparable data is limited, we would point to the Institute of Customer Service's (ICS) "UK Customer Satisfaction Index"[1] as an indicator of 'normal' customer service levels across the UK economy over time: details of which we have included in appendix 1.

That report shows that customer satisfaction across the UK economy has fallen continually since 2013, just before the launch of the price control period. Among UK utilities, the worst performing sector, average satisfaction scores are reported between 69% and 71%.

SHE Transmission has bucked this trend of deterioration and has consistently out-performed the sector average.

We would therefore refer back to our Technical Report submitted as appendix 1 to our letter "*Re: SHE Transmission plc Special Condition 3D Stakeholder Satisfaction Output*" on 30th April, 2013. At that time, our survey provider, TTI Global, recommended a benchmark of between 5 and 6 based on dry run data and their experience in the industry.

To reflect the uncertainty in the limited data, Ofgem has determined years 1 and 2 survey baselines at the lower limit of that recommendation, 5. Should Ofgem wish to revisit this for later years, we recommend that baseline remains at 5 until that review. If Ofgem is intent on modifying the baseline after year 3 then it will be essential to ensure that the maximum reward is achievable.

Key Performance Indicators

We advised Ofgem of our preliminary KPI score of 77%, subject to confirmation for 2014/15. The information has now undergone our data assurance procedures, and the figure has been revised to 86%. Based on the consultation we presume this would change our KPI baseline to 89%.

We put forward our views on this in our previous letter on 16th June. Operating within a range from 89% to 100% would see steep changes in financial reward for small improvements in performance. We recommend the baseline remains at 50% for years 3 and 4, particularly if Ofgem intend to review the incentive for years 5 to 8.

Our letter noted joint KPIs as a departure from RIIO-T1 principles: our opinion remains that KPIs should be tailored to our stakeholders, over and above licence requirements, with comparability to other TOs a secondary consideration. However we will test that view as we review our KPIs for year 4 and beyond.

Next steps

We thank you for the opportunity to contribute to the ongoing development of the incentive. We note that Ofgem intends to discuss how Transmission Owners can aim for the full reward and look forward to participating in those discussions.

Yours sincerely,

Barry Byrne

Networks Regulation, Transmission

[1] See https://www.instituteofcustomerservice.com/10560/UK-Customer-Satisfaction-Index---UKCSI.html

Appendix 1 – Data from the UK Customer Satisfaction Survey – carried out the by Institute of Customer Service

Figure 1 – Trends in customer satisfaction, January 2015

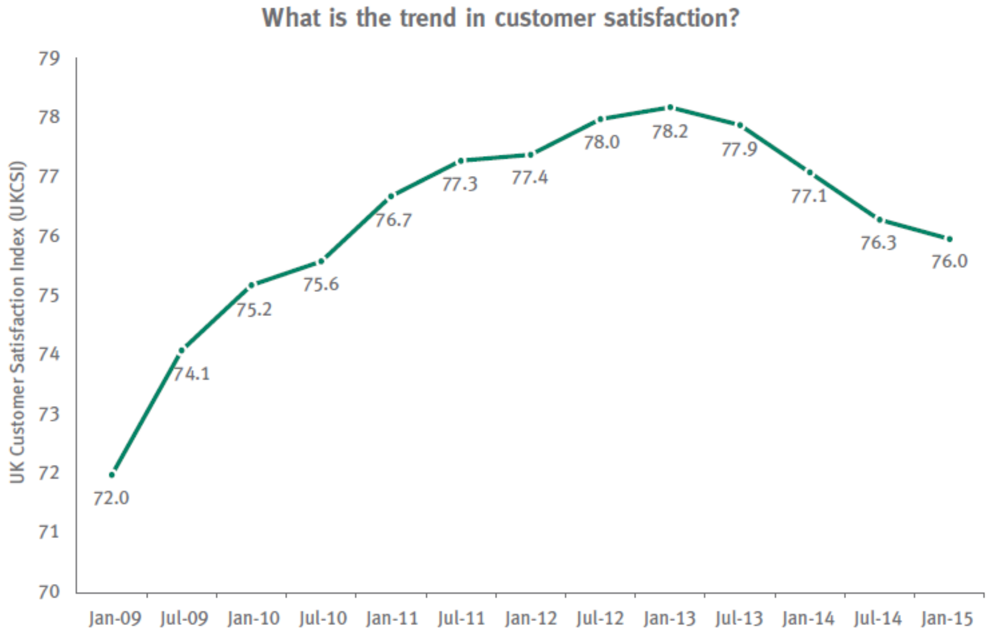
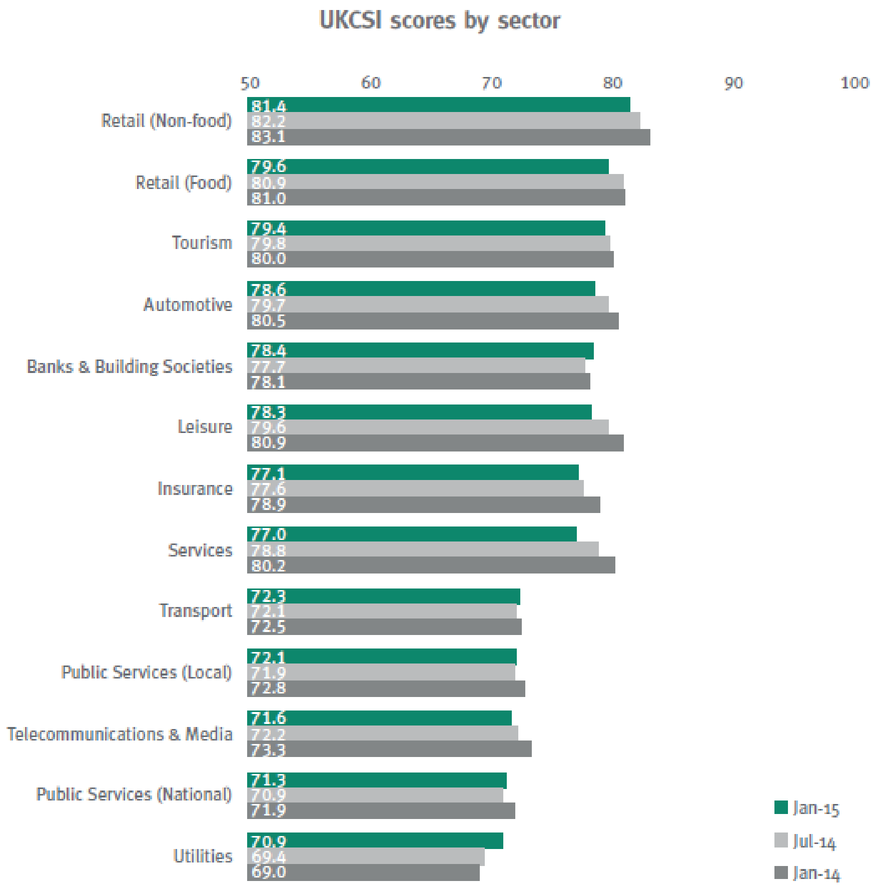


Figure 1 – Trends in customer satisfaction by sector, January 2015



The scores in the index do not offer a direct comparison with our stakeholder survey: most notably, the index covers customer satisfaction, not stakeholder satisfaction. The respondents answer questions on industries as diverse as leisure to utilities, not limited to electricity transmission. Results are a composite score of multiple metrics rather than our single satisfaction question. Data is collected from online panels rather than by telephone, and the sample of over 10,000 respondents is representative of the UK rather than our tailored stakeholder groups.

Nevertheless, we feel the data does shed light on what could be regarded as 'normal' or 'business as usual' service levels across the UK. From that, we see a continual overall deterioration from 2013 (figure 1, appendix 1). Broken down into sector, we see utilities (gas, water and electricity) as the poorest performing sector but the only one to show improvement since 2013 (figure 2, appendix 1).

Contributing to the All-Party Parliamentary Group (APPG) on customer service in July 2014 and October 2014, the ICS described the "*considerable disparity...in the utilities sector and examples of companies who do demonstrate above average customer satisfaction*."[2]

Owing to the different methodologies, we hesitate to compare our scores directly with the ICS findings. But we do think the downward trend in service across the wider economy, and the disparity within the utility sector throw doubt on the assumption that our year 1 and 2 scores are 'normal.'

We are proud of the performance we have achieved so far in RIIO-T1. We have set a high standard early on and delivered improvements when most other sectors have receded. Establishing a baseline from this level of service introduces a greater risk of penalty for exceeding expectations.

[2] See http://www.instituteofcustomerservice.com/files/APPG_on_Customer_Service-The_State_of_customer_service_in_the_utilities_sector_13102014_Final.pdf