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Dear Geoff

**RIIO-T1: Consultation on values within the stakeholder satisfaction output arrangements**

This response is from SP Transmission plc (SPT) the onshore Transmission Owner (TO) for the South of Scotland. Thank you for the opportunity to respond to Ofgem's further consultation on the values within the stakeholder satisfaction output arrangement.

We fully support Ofgem's decision to review the current incentive to ensure that it continues to deliver benefits to all stakeholders; however, we do not support the current proposals to:

1. Apply Ofgem's proposed baselines for the duration of the price control; or
2. Switch off the relevant components of the incentive for years 1-3 and only applying Ofgem's proposed baselines to years 4-8 of RIIO T1

We do not agree with the justification for Ofgem's January 2016 decision and recommend that the November 2015 decision should stand in respect of baseline values.

Background

We have proactively supported the development of an incentive for customer and stakeholder satisfaction for RIIO-T1 since before the start of the price control period in 2013. It has been challenging to identify and agree appropriate measures for TO's in this area, not least because of the complex arrangements for customer engagement imposed by the System Operator/Transmission Owner Code (STC). This complexity is increased when the requirement to demonstrate effective separation across our historically vertically integrated businesses is considered. Additionally, the limited number of direct and indirect customers or stakeholders for transmission in Scotland could result in an abnormal distribution of results from survey responses.

Notwithstanding these challenges, we developed a range of performance measures that we believed best reflected our performance in areas that influence stakeholder satisfaction and reinforced the STC and business separation obligations. For these reasons we proposed a set of key performance indicators (KPI's) that aligned with the established processes defined in the STC that would support existing industry arrangements and target the improvement of performance beyond compliance in these areas. These KPI's were identified to drive outputs that would lead to an improvement in customer satisfaction. This was understood and supported by Ofgem at the time leading to our RIIO-T1 proposal in April 2013. The challenge of setting baseline values was also

reflected in our proposal and accommodated by allowing for the adjustment of the baseline values and weighting factors through the RIIO-T1 period.

The first three years of RIIO T1 have seen significant changes and development of our stakeholder strategy and engagement. This is reflected in reasonable performance in our stakeholder surveys and in KPI's. This demonstrates the incentive has been effective to drive improvement in the stakeholder engagement actions carried out in the previous price controls. Whilst we appreciate Ofgem's wish for this incentive to be as challenging as possible for Transmission companies, we do not believe it is appropriate to retrospectively change the incentive baseline values for years 1-3.

We are therefore supportive of the principle that changes to the current stakeholder satisfaction arrangements for transmission companies are tabled. However, we do not agree with the justification for the revocation of the November determination, nor the proposal to retrospectively set new baseline values.

### Recent Ofgem Decisions

It is not clear why the decision notice dated 6<sup>th</sup> November 2015 determining values for the baselines, caps, collars and weightings of the stakeholder satisfaction survey and key performance indicators of the electricity transmission and gas transmission owners (the 'November Decision') was revoked. Ofgem published a notice on 15<sup>th</sup> January 2016 revoking the November Decision on the basis that the relevant licence condition permits only a single value to be determined per algebraic term in the licence, whereas the November Decision purported to determine two values for eight of the algebraic terms. However it was our understanding that the algebra was drafted as it currently stands to allow for such modification when required. This is particularly relevant for the KPIs which are intended to develop and change through the period as per paragraph 3D.24 of our licence which states:

*"The licensee must, subject to paragraphs 3D.25 and 3D.26 of this condition, make such modifications to its Key Performance Indicators as may be required to better measure the service provided."*

We do therefore not agree with Ofgem's decision in January 2016 to revoke its November Decision on these grounds and do not believe that more than one set of values cannot be used. Indeed the options Ofgem are proposing in this current consultation seem to require two sets of values to be applied for the weighting values of X, Y and Z and will require modification of the relevant licence conditions..

Our recommendation is that the decision of November 2015 should stand in respect of the proposal for adjusting the baseline values.

### Regulatory Uncertainty

We do not think it is appropriate for the incentive arrangements for first three years of RIIO-T1 to be revised, as would be the case under both of the proposed options. The proposed changes will not only impact allowed revenue allowances but it will also create a negative precedent of regulatory uncertainty in price controls<sup>1</sup>. Making such a change would suggest that Ofgem can retrospectively open various areas of a closed price control. This goes against the principal of regulatory certainty. This would not be welcomed by SPT or its investors.

Ofgem has stated in previous consultations and decision letters that it does not think it is appropriate to revise the targets retrospectively, or, alternatively switch off the incentive.

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<sup>1</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31623/11-795-principles-for-economic-regulation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf) Page 10

On the 22<sup>nd</sup> June 2015, Ofgem published its initial consultation on values within the stakeholder satisfaction output arrangements, in which it stated:

*“Given years 1 and 2 of RIIO-T1 are now complete, we do not propose to direct values away from their expectations in this area for the first two years of RIIO-T1. These were the values the companies used as part of their annual reporting.”*<sup>2</sup>

In the decision notice published on the 6<sup>th</sup> November 2015 in relation to the baseline value of 5 for the stakeholder satisfaction survey for years 1 and 2, Ofgem stated:

*“Whilst with hindsight we would have preferred to have set a more challenging baseline for these years, we do not think it is appropriate to revise the targets retrospectively beyond what was used for regulatory reporting in these years”*<sup>3</sup>

In this decision, Ofgem concluded that the baseline values for 2013-2015 would not change.

*“Given a lack of evidence at the time of RIIO-T1 Final Proposals, we denoted certain values by a series of letters, to be determined at a later date. These included the stakeholder satisfaction survey baseline and cap/collar (where relevant), key performance indicator baseline and the relative proportions of components within each TO’s incentive. This consultation covers our proposals for those values”*

Ofgem’s clear position on the possibility of revising the targets for the previous years therefore created a legitimate expectation that the baseline would not be retrospectively revised. In the current consultation dated 27<sup>th</sup> April 2016, Ofgem state that:

*“We no longer consider it necessary or appropriate to keep the baseline at a lower level for the early years of the incentive because of the caveats we included around the use of these lower baseline figures for reporting purposes.”*<sup>4</sup>

However it is not entirely clear why Ofgem no longer considers it appropriate to keep the baseline at the lower level for years 1 to 3 as sufficient reasons have not been provided. Ofgem acknowledges that, in relation to the option of ‘switching off’ the incentive, *“this proposal is not aligned with the original intent of the incentive”*<sup>5</sup>. The November decision was revoked on 15<sup>th</sup> January 2016 as, in Ofgem’s view;

*“The mechanism for determining the relevant values as set out in the Relevant Licence Conditions permits only a single value to be determined per algebraic term in the licence, whereas the Decision purported to determine two values for eight of the algebraic terms. In order for it to be possible to determine more than one value per algebraic term, the Relevant Licence Conditions would need to be modified pursuant to the formal statutory procedure”*

We believe that the above statement is at odds with our previous understanding and would therefore welcome clarity on this point. Our understanding was that the reason for not setting the

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<sup>2</sup> Ofgem, ‘Consultation on values within the stakeholder satisfaction output arrangements (electricity transmission licence, special condition 3D and gas transporter licence, special condition 2C)’, 22 June 2015, page 3

<sup>3</sup> Ofgem, ‘Decision on values within the stakeholder satisfaction output arrangements (electricity transmission licence, special condition 3D and gas transporter licence, special condition 2C)’, 6 November 2015, page 4. See also page 5: *“We will set the baseline at 50 for years 1 and 2. While this is relatively low, we do not think it is appropriate to revise the targets retrospectively beyond what was used for regulatory reporting in these years”*.

<sup>4</sup> Ofgem, ‘RIIO-T1: Consultation on values within the stakeholder satisfaction output arrangements’, 27<sup>th</sup> April 2016, page 4

<sup>5</sup> Ofgem, ‘RIIO-T1: Consultation on values within the stakeholder satisfaction output arrangements’, 27<sup>th</sup> April 2016, page 12

licence values at the start of RIIO-T1 was to allow the values to update these throughout the price control as performance was reported and changing stakeholder priorities evolved.

It is also our understanding that the two proposals under the current consultation will require modification of the licence conditions which appears to contradict the justification for revoking the November Decision. This explanation therefore does not provide sufficient reasons for Ofgem's decision to revoke its November Decision.

#### KPI and Stakeholder Weightings

As we stated in our response to your consultation of June 2015, the British Electricity Trading Arrangements regulations require that communication between the TO and a customer must be via the National Grid, (SO) and not directly between the TO and the customer. These processes form part of the STC. As a result, the stakeholder satisfaction survey may not be able to reflective of our performance as the KPIs. This is because we have direct control of the processes the KPI's measure.

The British Electricity Trading Arrangements regulations require that communication between the TO and a customer should be led by National Grid, the System Operator (SO) and limits direct interaction between the TO and the customer. These processes form part of the System Operator Transmission Owner Code (STC). As a result, we consider the stakeholder satisfaction element of the survey may be a less effective measure of our performance compared to our KPI's and the weighting factors should reflect this.

We wish to emphasise that we hope to be able work with Ofgem to agree a proposal for the stakeholder satisfaction incentive outputs which will benefit stakeholders whilst providing regulatory certainty for Network operators. Should you require any further clarification on any of our responses and our more detailed answers in Appendix 1, please do not hesitate to contact me.

Yours sincerely,



Alan Kelly  
**Transmission Commercial and Policy Manager**  
SP Energy Networks (SPEN)

Enclosed: Appendix 1 Responses to Consultation Questions

## **Appendix 1: Responses to Consultation Questions**

### **Question 1: Do you agree with our proposal to use the mean of the outturn data across TOs to set a robust baseline?**

We agree this is a reasonable approach and this was considered when drafting the original licence proposals. Nevertheless, since the submission of our proposal in April 2013, the prospect of adjusting the values retrospectively was never discussed with Ofgem in finalising the financial model values in 2015. It was understood via direct conversation with Ofgem's representatives that the proposed baseline values we submitted would be fixed for the first 2 years of RIIO-T1 and therefore our annual revenue submission could be completed based on these values.

Therefore, should this proposal be adopted it should only be applied for future years and not retrospectively.

### **Question 2: Which of our two lead options for setting the survey baseline do you prefer?**

We do not support the current proposals to:

1. Apply Ofgem's proposed baselines for the duration of the price control; or
2. Switch off the relevant components of the incentive for years 1-3 and only apply Ofgem's proposed baselines to years 4-8 of RIIO T1

Our view is that neither of these approaches is appropriate and the November 2015 decision should stand. We believe this unexpected retrospective change undermines the principle of regulatory certainty which underpins The previous consultation and November Decision created a legitimate expectation that the values for the early years of the price control would not be retrospectively amended.. Furthermore, both options involve using two values of the weighting factors (X,Y,Z), which appears to contradict the justification for revoking the November Decision according to Ofgem's revocation notice in January 2016.

### **Question 3: Are there any other policy proposals for setting the survey baseline that you think are more appropriate?**

Please see our answer to question 2 which supports the November 2015 decision proposals

### **Question 4: Do you agree with our rationale for setting the baselines for the KPI component of the stakeholder satisfaction output arrangements?**

Please refer to our answer at question 1.

### **Question 5: Which of our two lead options for setting the KPI baselines do you prefer?**

As previously stated, our recommendation is that the determination of November 2015 should stand (the revised KPI baseline should only be applied prospectively and the original baselines retained for years 1-3)

### **Question 6: Are there any other policy proposals for setting the KPI baselines that you think are more appropriate?**

Please refer to our answer at question 1.

**Question 7: Do you agree with our proposal to amend the licence algebra for the Scottish TOs should we implement baselines for the KPIs and the stakeholder satisfaction survey above 60 & 6 or below 40 & 4?**

Yes, we agree with the proposal to extend the licence algebra should the revised KPIs be implemented.

It is not clear how Ofgem have calculated the caps and collars therefore we would welcome more information. We agree with Ofgem that the approach taken in National Grid's licence is reasonable.

We note that in the proposed licence drafting placeholder values (letters X,Y,Z etc) still exist. As a result of Ofgem's limited reasoning for retracting its November Decision, we would only expect to see final hard coded values in the licence drafting if the principle of setting a single set of values for the full price control is adopted.

**Question 8: Do you agree with our proposal to modify National Grid Electricity Transmission's licence to correct a typographical error?**

Yes, it is sensible to remove any references to the year 't' instead of 't-2' so that this is consistent with the current price control terms.

**Question 9: Do you agree with our proposals for the weightings for the component parts of the incentive for National Grid and the Scottish TOs? If you consider there to be an alternative and well-justified basis for setting the weightings, we welcome views on this.**

Although we have stated that the November 2015 Decision should stand in respect of the baseline values, we did not agree that its proposal to alter the KPI weightings was appropriate. Our view remains that it would be more appropriate for the original weightings to stand (higher weighting of KPIs: survey).

Our reasoning for this is because, the British Electricity Trading Arrangements regulations require that communication between the TO and a customer must be via National Grid, the SO and not directly between the TO and the customer. These processes form part of the STC. As a result, the stakeholder satisfaction survey is not as reflective of our performance as the KPIs. This is because we have direct control of the processes the KPI's measure.

By giving higher weight to the survey, we may see performance fluctuating year on year due to this more arbitrary means of measuring stakeholder satisfaction for the Scottish TOs.

**Question 10: Do you agree with our suggestion to use the weightings to effectively switch off the incentive should Option 2 be the preferred option?**

We do not think the weighting should be used if it is Ofgem's view that it is not possible to apply two sets of values in the relevant licence condition. Following this option would contradict Ofgem's revocation of its November Decision on the basis that two values per algebraic term could not be used. Furthermore, we believe that amending a licence retrospectively is inappropriate.

Therefore, of the two options proposed it would be clearer to state that the start date of the incentive is year 4 of the price control. However, we do not agree with the proposal to switch of the incentive from the start of the price control.

**Question 11: Do you agree with our proposals to set the caps and collars for NG's and the Scottish TOs' stakeholder satisfaction survey at +/-1.6 around the baseline?**

We agree with this proposal on the basis that this is consistent with the existing licence condition.

**Question 12: Do you agree with our proposals to set the caps and collars for SHE Transmission's KPI at +/-11 around its baseline (ie 100 and 78 respectively)?**

We recognise that it is difficult to identify consistent ranging for both companies given that we have different KPIs.

**Question 13: Do you agree with our proposals to set the caps and collars for SP Transmission's KPI at +/-16 around its baseline (ie 85 and 53 respectively)?**

We agree that the values for SPT are reasonable.