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Dear Grendon

We are writing in response to your consultation on the evaluation process for the 2019-20 ESO regulatory incentives framework. This submission is entirely non-confidential and may be published on your website.

You propose two simple revisions to the framework. First, that the evaluation process is carried out by role rather than more narrowly by principle. The effect and intention of this revision is to respond to practical problems caused by perceived overlaps between the principles that have made evaluation on that basis difficult. Second, that the rewards and penalties associated with these four roles are split into three groups, with the potential for a maximum reward or penalty of £10m accruing to each (allowing for a maximum annual reward or penalty of \pm £30m under the scheme). This would contrast with the current arrangement where each of the seven principles has one-seventh of the \pm £30m maximum reward or penalty allocated to it.

We fully support both changes. The four roles are more thematically coherent and less prone to overlap than the seven principles are, and this should help the Performance Panel, stakeholders, Ofgem and the ESO itself in the categorisation and evaluation of activities. While the division of the \pm £30m pot into thirds remains somewhat arbitrary, and could drive inefficient behaviour in some cases,¹ it is nonetheless considerably less arbitrary than its division into sevenths. The potential reward or penalty associated with outperformance or underperformance in any given work area will be sharpened as a result of these changes.

The new ESO incentive scheme design is not without wider issues. The roles, and the metrics used to assess against them, cover a range of behaviours and market characteristics that vary significantly in terms of their controllability by the ESO, in how measurable they are, and in terms of how immediately any benefits are realised. Where activities are highly controllable and measurable by the ESO, and results can be seen quickly - for example, in areas like the time taken to resolve billing queries or make connection offers - the evaluation process appears quite straightforward and objective. But in other areas, in particular around facilitating

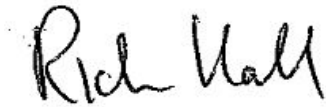
¹ For example, that the equal weighting may encourage the ESO to put equal effort into delivery in each of the three areas, even if bigger wins are possible in one area.

market plurality and long term whole systems thinking, matters which are not solely within the control of the ESO, and the success or failure of which may not become manifest until many years after the review year, it is considerably more difficult to make an evaluation. Our perception is that all parties to the process struggled somewhat to develop and apply clear evaluation criteria in these more speculative areas during the first mid year assessment process. That fog may clear with experience, and as the reiteration of the process builds a common understanding, but Ofgem's assistance in trying to pin down 'what success looks like' and how it can be measured - particularly in relation to Roles 3 and 4 - would be welcome.

Notwithstanding these teething issues, we think that the direction of travel on the ESO scheme is the right one. It has already resulted in a much higher degree of transparency on the ESO's activities than has previously been the case and should enhance its accountability and performance further in the coming years.

I trust that this response is clear, but would be happy to discuss any matter raised within it in more depth if that would be helpful.

Yours sincerely

A handwritten signature in black ink that reads "Rich Hall". The signature is written in a cursive, slightly slanted style.

Richard Hall
Chief Energy Economist