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Environmental discretionary reward under the RIIO - T1 price control

Consultation

Reference:	17/12
Publication date:	7 February 2012
Response deadline:	3 April 2012

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Overview:

We are consulting on the form of an environmental discretionary reward (EDR) to complement the existing RIIO-T1 package for electricity transmission. The purpose of an EDR would be to sharpen companies' focus on strategic environmental considerations and encourage corporate and operational culture change to facilitate a growth in low carbon energy. The RIIO framework is very clear that transmission operators have a full role to play in the sustainable development of the energy sector while maintaining a safe, secure and affordable system for existing and future consumers. In the March RIIO strategy document we committed to adding a reputational incentive and consulting on the introduction of a financial incentive for this purpose.

Context

Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the electricity and gas industries in Great Britain. Our principal objective is to protect the interests of current and future gas and electricity consumers, where appropriate by promoting effective competition. Consumers' interests are defined in statute as including cutting carbon emissions and securing our energy supplies. Our statutory duties also cover the interests of vulnerable consumers, contributing to the achievement of sustainable development and ensuring that licensed electricity and gas companies are able to finance their activities.

Environmental objectives are central to the current and future development of the energy sector, driven in large part by EU and UK decarbonisation, renewable energy and security of supply objectives. The electricity sector is expected to make a substantial contribution to the achievement of these environmental targets through increased deployment of low carbon generation technologies. Our duties and approach to regulating the sector have developed to reflect these imperatives.

Decarbonising the UK's electricity supply will depend on the timely provision of supporting transmission infrastructure delivered by the electricity transmission owners (TOs). As part of the next transmission price control, RIIO–T1, the TOs have submitted their RIIO-T1 business plans which forecast £18 billion of investment in the GB transmission system from 2013 - 2021 to connect new sources of low carbon generation to meet Government policy targets.

The regulatory framework has evolved in recognition of the need to incentivise and support transmission infrastructure development. The new RIIO framework (Revenue = Incentives + Innovation + Outputs) contains outputs and associated targets against which we will assess the TOs' performance. TOs are incentivised to perform strongly against outputs such as delivery of timely connections, efficient investment in wider system reinforcement, customer satisfaction and managed environmental impacts to deliver low carbon energy. In our March publication on the RIIO-T1 framework we committed to adding a reputational incentive on the TOs contribution to the objective of decarbonisation to the output framework and consulting on whether to introduce financial incentives for this purpose.

This consultation sets out our thinking on these further incentives, and the form that they should take. It sets out the case for adding an environmental discretionary reward (EDR) to complement the existing RIIO-T1 package for electricity transmission. The purpose of an EDR would be to sharpen companies' focus on strategic environmental considerations and encourage corporate and operational culture change to facilitate growth in low carbon energy. We are also seeking views on our proposals for an annual process to put the EDR into practice.

Subject to responses to this consultation, we expect to set out our final decision in spring 2012.

Associated documents

- Initial assessment of RIIO-T1 business plans and proportionate treatment

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanletter.pdf

- RIIO-T1: Transmission companies' business plans - publication and next steps

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1busplans.pdf

- Decision on strategy for the next transmission price control - RIIO-T1

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf

- Consultation on strategy for the next transmission price control - RIIO-T1 Overview paper

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1%20overview.pdf

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Executive Summary

Decarbonising Britain's electricity supply will depend on the timely provision of supporting transmission infrastructure delivered by the electricity transmission owners. In December 2010 we consulted on the inclusion of a broad environmental measure within the RIIO-T1 framework as part of the package of incentives for TOs to deliver outputs and facilitate progress towards the UK's low carbon goals.

In our March 2011 RIIO-T1 strategy decision document[1] we committed to implementing a reputational incentive and consulting on a financial incentive on TOs' contributions to the policy objective of decarbonising the energy sector. Our decision reflected the views expressed by consultation respondents, who supported the concept of a broad environmental measure to encourage TOs to incorporate environmental goals into their business strategy and operational practices while addressing concerns that an automatic financial incentive could reward or penalise TOs for outcomes outside of their control.

We think that consumer interest could be promoted further through a targeted and discretionary mechanism that focuses on aspects of the TOs' role which do not feature explicitly in the proposed incentives and that seeks to identify whether the TO has a systematic approach to facilitating a low carbon energy system. This document sets out our proposal for an Environmental Discretionary Reward (EDR), a financial incentive scheme to encourage the TOs to play an active role in the transition to a low carbon energy sector. The purpose of the EDR is to sharpen the TOs' focus on developing effective capability to undertake their role in the successful transition to a low carbon economy.

We recognise that a number of the RIIO-T1 output measures and incentive mechanisms reflect the different aspects of the TOs' expected role. We have proposed the EDR, in addition to the other incentives and environmental performance requirements in RIIO-T1, because we think it creates a more comprehensive set of environmental output measures. In assessing performance and making awards, account will be taken of rewards already earned elsewhere within RIIO-T1.

We are seeking views on the EDR concept which we have outlined in this document. The EDR would be based on meeting two conditions:

1) Scoring a level to be determined on an **environmental balanced score card**, comprising six key strategic and operational environmental issues against which each of the TOs will be measured and scored

2) **Publishing an annual executive level planning statement and consulting on that statement**. The CEO of the TO would present this document to stakeholders.

We propose that each year the TOs will demonstrate their performance against the EDR's requirements to a panel of experts. The panel would then recommend the level of any reward made. £4 million annual funding, up to a total of £32 million

[1] www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes

over the price control period, is available with up to half the annual allocation being rolled over into the next year if the full amount is not awarded. A reward would only be awarded for meeting the required level of performance in part 1) as well as meeting the requirements of 2).

1. Introduction

Chapter Summary

This chapter sets out the background to this consultation and gives an overview of the Environmental Discretionary Reward proposals and the structure of this document.

Background to consultation

1.1. Transmission networks are the high voltage electricity wires and high pressure long distance gas pipelines which convey electricity and gas from power stations and offshore facilities to industrial consumers and to the local distribution networks. They are owned and operated by privately owned companies who have territorial monopolies.

1.2. Transmission charges make up approximately two per cent and three per cent of an average household energy bill for gas and electricity respectively. To protect consumers' interests we set regulatory price controls to allow the transmission owners (TOs) to recover their costs and earn an efficient return on their investment. Price controls apply to one gas and three electricity transmission companies. These are:

- National Grid Gas plc (NGG), which owns the high pressure gas transportation system across Britain
- National Grid Electricity Transmission plc (NGET), which owns the high voltage electricity network in England and Wales
- SP Transmission Limited (SPTL), which owns the high voltage electricity network in the south of Scotland
- Scottish Hydro Electric Transmission Limited (SHETL), which owns the high voltage electricity network in the north of Scotland.

1.3. The next gas and electricity transmission price control (RIIO-T1) will run for an eight-year period from 1 April 2013 to 31 March 2021. This will be the first transmission price control to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. It will set the outputs that the four TOs need to deliver for their consumers and the associated revenues they are allowed to collect.

1.4. Over the next price control period, the electricity TOs have a critical role to play in connecting a large amount of new and low carbon sources of energy to consumers. This is primarily driven by the need to decarbonise Britain's energy sector to meet the following environmental targets:

- an EU target for the UK to source 15 per cent of its energy from renewables by 2020

- a national target to reduce 1990 levels of greenhouse gas emissions by 80 per cent by 2050.

1.5. Significant investment will be needed across the three electricity transmission areas by 2020 to connect new sources of generation. Each TO will also need to work actively with other industry parties to ensure that these challenges are met in a way that maintains a safe, secure and affordable system for existing and future consumers.

1.6. Under RIIO-T1 we have set a number of outputs that TOs will have to deliver that will contribute directly to achieving these strategic objectives. These are: safety, reliability, customer satisfaction, direct environmental impact and contribution to the UK's broader energy and environmental objectives, timely connections, and investment in wider system reinforcement.

1.7. In our March RIIO-T1 strategy publication[2] we committed to introducing a reputational incentive on the TOs' contribution to the broad environmental objectives of decarbonisation. We also said we would consult on introducing financial incentives in this area. This document discusses our further thinking on an additional financial incentive to drive the TOs to meet the challenges of the low carbon energy transition during RIIO-T1.

1.8. We are specifically seeking views on adding a further measure, an EDR, to complement the RIIO-T1 package for electricity transmission companies during the RIIO-T1 price control period. The purpose of an EDR would be to sharpen companies' focus on strategic environmental considerations and to encourage corporate and operational culture change to facilitate low carbon energy.

Consultation proposal

1.9. This consultation document invites stakeholders' views on our proposal to introduce an annual EDR. The EDR will be based on meeting two conditions:

1) Scoring a level to be determined on an **environmental balanced score card**, comprising six key strategic and operational environmental issues against which each of the TOs will be measured and scored

2) **Publishing an annual executive level planning statement and consulting on that statement**. The CEO of the TO would present this document to stakeholders.

A reward would only be awarded to TOs that is assessed as having excellent performance in part 1) as well as meeting the requirements of part 2). A reward of up to a maximum of £4 million across all the electricity TOs would be available annually (from a total incentive pot of £32 million over the eight year price control). If we introduce the EDR, TOs would apply to us annually for the reward. As part of the process that we would develop, we propose that TOs would complete

[2] http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf

a scorecard reporting template (Appendix 2). We would publish further guidance on this process to inform and guide TOs, in particular the scoring process and what would constitute excellent performance. We would make an assessment of the TOs' EDR applications for consideration by the panel of independent experts. The panel would determine any reward for the preceding financial year by October of the subsequent financial year in a transparent manner and publish its assessment. The first reward could be announced in October 2014. We would regularly review the EDR and consult on any change to the reward criteria if we deemed changes to be necessary.

Structure of this document

1.10. The remainder of this document is structured as follows:

- Chapter 2 describes our process to date
- Chapter 3 sets out our further thinking on the consumer interest from applying additional financial incentives to drive TOs contribution to the transition to a low carbon energy sector
- Chapter 4 gives more detail on how we envisage the EDR proposal might work including its governance arrangements
- Chapter 5 sets out the next steps.

2. Process to date

Chapter Summary

This chapter sets out the process leading up to this consultation.

Consultation on RIIO-T1 environmental outputs

2.1. In December 2010 we published a consultation strategy document[3] on proposals for the RIIO-T1 outputs that TOs would be required to deliver over the next price control. In that consultation we asked for stakeholder views on addressing environmental impacts of the networks through outputs linked to:

- broad environmental impacts related to the contribution of the TOs to the transition to a low carbon economy, with an automatic financial incentive linked to the UK's renewable energy targets as proposed by Renewable UK

- direct network emissions including losses in electricity transmission, business carbon footprint, sulphur hexafluoride emissions and gas shrinkage and venting

- wider environmental footprint (visual amenity and socio-economic impact).

2.2. With respect to the proposal for a broad environmental output and automatic financial incentive, respondents' views were mixed. Some stakeholders said that a broad environmental output would fit well within the RIIO performance model. Others expressed concerns about the form of incentive proposed by Renewable UK. These included the risk of possible financial windfall gains/losses to the TO resulting principally from the actions of others (specifically those developing – or failing to develop – renewable energy generation projects), and the potential for consumers to pay double for the same output and the costs of the transition. There were mixed views as to whether a reputational or a financial incentive should apply to such an output.

Decision on RIIO-T1 environmental outputs

2.3. In March 2011 we published our decision document[4] on the strategy for the next transmission price control, RIIO-T1. Following consideration of stakeholders responses to our December consultation, we established the following environmental outputs:

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[3] For further information please see http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=28&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes
[4] For further information please see http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes

- **Business carbon footprint**: a reputational incentive on reporting against their business carbon footprint given that the TOs already take financial responsibility for their CO_2 emissions related to energy use in their buildings and operational sites under the Carbon Reduction Commitment Efficiency Scheme

- **Sulphur hexafluoride emissions**: a financial incentive based on the non-traded carbon price to manage emissions linked to the use of Sulphur Hexafluoride (SF_6) as an insulator in high voltage switchgear

- **Visual amenity issues**: TOs must demonstrate they have considered the socio environmental impacts of their business plans. We also outlined our intention to introduce an allowance per company to reduce the visual impact of existing infrastructure

- **Contribution to fewer transmission losses**: There would be a reputational incentive on transmission losses based on the TO's modelled baseline

- **Contribution to broad environmental objectives**: There would be a reputational incentive on low carbon energy flows. For the electricity transmission companies we also committed to consulting on a financial reward to facilitate a greater contribution to the UK's environmental objectives.

2.4. In relation to the further consultation we said we would look at the potential to introduce a financial reward for the electricity transmission companies based on:

- an automatic incentive linked to a measure of the carbon intensity of energy flows as well as the annual increase in low carbon energy flows, and/or

- a discretionary reward if companies could demonstrate they have made a contribution that is in addition to those already rewarded under either the automatic incentive or the wider outputs framework.

3. The case for financial incentives

Chapter Summary

This chapter considers the consumer interest of putting additional financial incentives on TOs' contribution to strategic environmental objectives.

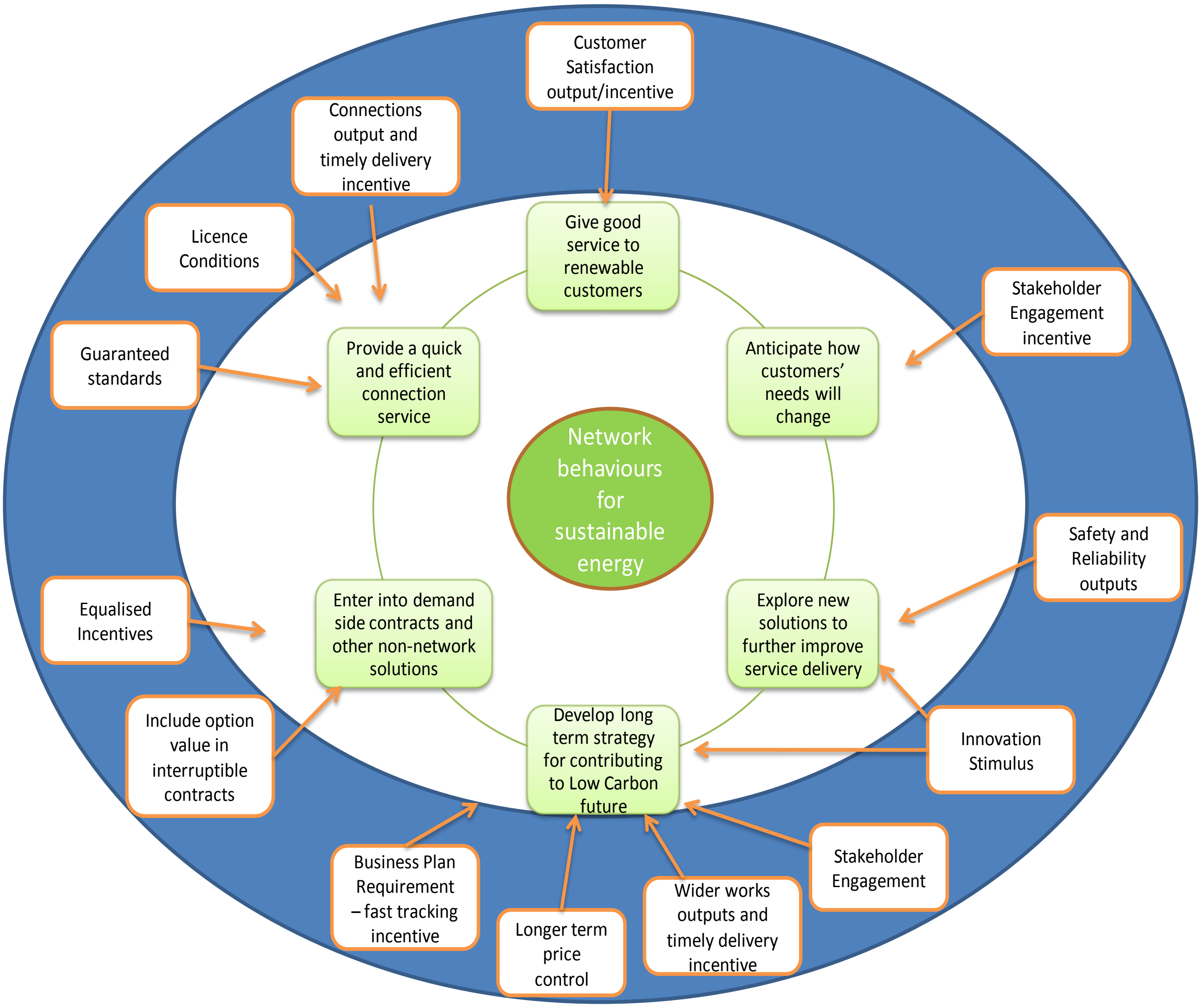
Strategic environmental considerations under RIIO-T1

3.1. TOs have a vital role to play in the transition to a low carbon economy. A number of proposed RIIO-TI output measures and incentive mechanisms reflect different aspects of that role, as illustrated in diagram 1.

3.2. Outputs such as timely connections and efficient wider reinforcement works map directly to TOs accommodating a large amount of new and low carbon generation. Others such as ongoing stakeholder engagement incentives and customer satisfaction will help to ensure that the companies seek to anticipate customer needs and provide good levels of customer service to all new generators, including low carbon. The framework also highlights that TOs should clearly demonstrate that their plans represent long term value for money to consumers overall, taking into account wider considerations such as environmental targets.

3.3. Importantly, under this incentive framework, TOs that innovate and deliver efficiently against these outputs will receive higher returns. Conversely, those that do not perform well will face penalties and lower returns. The RIIO-T1 process has been formulated to link a TO's returns to the progress they make in contributing to the achievement of the UK's low carbon and renewable energy objectives.

Diagram 1: Elements of the RIIO price control aimed at facilitating the delivery of the environmental targets



Have companies responded fully to the challenge?

3.4. In July the TOs submitted their RIIO-T1 business plans. In their business plans, each TO set out a 'best view' of the likely level of activity it expects to undertake during RIIO-T1, to deliver its outputs and meet customer requirements. Each TO's best view is based upon the *Gone Green* scenario from the industry review of strategic transmission investment needed for the UK's 2020 renewable energy target. This has translated into a high level recognition by the TOs of new connections capacity to be accommodated over the RIIO-T1 period (see Table 1).

Table 1: TOs' 'best view' of new generation to be accommodated by end of RIIO-T1 in July business plans

Transmission owner	New connections (MW)
SHETL	7,300
SPTL	2,500
NGET	18,000
TOTAL	**27,800**

3.5. TOs need to demonstrate that they have in place a system to identify risks and opportunities in their business approach to facilitating the low carbon and renewable policy targets. Arguably, the alignment of TOs' corporate behaviour, business practices and processes with the low carbon agenda is implicit with delivering against the RIIO-T1 outputs. However, we would expect the TOs to have considered more explicitly in their business plan what they need to do in relation to developing capability to play their role in the transition to the low carbon energy sector. For example, the development of more customer-focussed processes, the provision of information targeted appropriately to specific audiences, as well as initiatives to promote a strong corporate and operational culture to facilitate low carbon investment.

3.6. Also, some industry stakeholders such as Renewable UK have put forward the case for TOs to be more transparent about how low carbon considerations have been embedded in their strategy and operational practices.

3.7. RIIO-T1 measures are already aiming to improve the customer experience of connecting to and using the electricity network, including the anticipated growth of low carbon generation. However, for the reasons we have outlined above, we were persuaded by the need to consider a broad environmental output measure (whether automatic or discretionary).

Type and size of financial incentive

3.8. Some stakeholders believe that the best way to ensure TOs fully contribute to the low carbon agenda would be to expose them to an automatic financial incentive linked to the UK's renewable target or the carbon intensity of electricity. In response to such an incentive TOs would transform their actions, including connection activities, wider network investment activities and culture, to facilitate the delivery of low carbon generation.

3.9. Since the publication of our March Strategy document, we have received additional information from RenewableUK on the case for an automatic financial incentive based on the carbon intensity of grid electricity. The main points raised in this additional material are:

- Difficulties in relation to grid connection and access can raise the cost of new low carbon projects and restrict investment.

- An explicit incentive has potential real benefits. At a societal level, this could result in carbon saving benefits through the advancement of new low carbon generation as well as lower generator subsidies paid for by consumers. For onshore wind developers RenewableUK has estimated it could provide benefits between £7.7k and £15.4k per megawatt of installed capacity.

- A measure based on the carbon intensity of grid electricity would give TOs freedom to modify their behaviour and actions as they see fit in pursuit of decarbonisation.

3.10. This information has usefully informed our thinking about the areas where TOs have a key role to play and where additional measures might complement the price control package. However, we remain unconvinced that an automatic financial incentive is the most appropriate way to incentivise the TOs play a full role at this stage. We do not think that the key concerns, raised by stakeholders to our December RIIO-T1 consultation would be addressed by applying an automatic financial incentive to a very high level output measure such as the carbon intensity of grid electricity. The key concerns are:

- **Double rewards**: There are specific outputs and associated incentives in the RIIO-T1 package that will directly contribute to key environmental targets. The introduction of an automatic financial incentive would duplicate the reward a TO received in relation to its performance against related outputs where these also contribute to the high level measure

- **Controllability**: TOs do not have full and direct control of the type, location or quantity of new generators that seek connection to their network. While TOs are directly responsible for their response and approach to meeting connection requests these will also depend on factors that are outside the TOs' influence, such as renewable and low carbon support policies, the planning regime and geographical resource potential. It would be difficult to distinguish between the influence of factors that are within the TOs control and those that are external if we used a high level measure of low carbon generation (or similar metric) to gauge TOs' contribution for an automatic incentive.

3.11. In their business plans the TOs have outlined their understanding of the significant increase in new and low carbon generation required to meet low carbon policy objectives. The RIIO-T1 package provides incentives for TOs to deliver outputs and to facilitate progress within the energy sector to meet the UK's low carbon goals. We have previously estimated that under RIIO we have greater certainty of delivery of a given level of outputs at a lower cost to consumers than would have been the case under the previous RPI-X regime. This is an important gain for consumers. Consumers pay for renewable and low carbon generation on the system through carbon pricing and Government renewable support policies. Therefore, it is important that the RIIO framework acts to facilitate the effectiveness of wider policy incentives rather than duplicate them. For this reason we do not consider that it would be effective or that consumer interest would be maximised from introducing an automatic financial incentive at this stage.

3.12. However, we do think that consumer interest could be promoted further through a more targeted and discretionary mechanism that:

- focuses on aspects of the TOs role which do not feature explicitly in the existing proposed incentives but demonstrate the extent to which a TO genuinely takes into account environmental goals in their business strategy and operational practices

- seeks to identify whether the TO has a systematic approach to facilitating the low carbon electricity system which is addressed in corporate strategy, policies and practices

- establishes challenging 'above and beyond' performance standards for those aspects of the TOs role which are to be included, or partially included, within the proposed RIIO-T1 incentive mechanisms

- ensures that, in assessing performance and making awards, it takes account of rewards already earned elsewhere within RIIO-T1

- sets reward levels to reflect the likely costs of achieving excellent performance (relative to poor performance), the need for a strong incentive to perform well and the benefits to consumers delivered by good performance

- be a public mechanism to create reputational risk and reward in relation to the TOs' planning and execution capability in relation to their role in the transition to the low carbon economy

- create momentum for ongoing corporate and operational culture change to underpin the facilitation of the low carbon economy.

4. The Environmental Discretionary Reward proposal

Chapter Summary

In this chapter we outline a proposal for the broad environmental financial incentive based on a discretionary reward.

Question box

Question 1: Do you agree it is appropriate to have an EDR?

Question 2: Do you support the proposed environmental balanced scorecard?

Question 3: Are we asking the right questions in the balanced scorecard reporting template we are asking Transmission Owners (TOs) to complete?

Question 4: Do you support the proposed requirement for TOs to publish an annual report on what they have in place to meet the requirements for the transition to a low carbon system?

Question 5: Do you believe the proposal would be effective in driving TOs towards facilitating low carbon energy?

Question 6: What is your view on the standards to be met to receive the reward and do you believe the level of the reward is appropriate?

Question 7: Do you believe the outlined timetable for making the reward is appropriate?

Introduction

4.1. In this chapter we outline our proposal for the broad environmental financial incentive based on a discretionary reward. We outline the rationale for the EDR and its proposed governance arrangements.

The EDR proposal

Aim and rationale

4.2. The EDR aims to encourage electricity transmission owners (TOs) to play a full role in facilitating climate change mitigation objectives, namely enabling the decarbonisation of electricity and minimising the harm of their operational and business activities on the environment. We believe a carefully designed incentive can drive corporate and operational culture change to facilitate low carbon delivery.

4.3. The scheme as proposed in this chapter is designed to reward the performance of those network companies which deliver environmental benefits and best serve the interests of customers. The level of performance needed to achieve a reward under this regime will typically exceed licence requirements.

4.4. In developing the EDR proposal set out below we have considered the operation of the Gas Discretionary Reward Scheme. While the aims and rationale of this scheme is not identical to the proposed EDR scheme, its operation does provide some useful learning. In this regard we regard the following as important for the operation of the proposed EDR:

- Specific scoring for the EDR with published guidance on what is required to achieve a particular score
- Limited overlap with other output measures
- The value of the reward is sufficient to fund the activities that the EDR drives and also offers a reward for highly scored outcomes

The proposal

4.5. The EDR proposal has been developed to drive the right behaviour and be measureable.

4.6. The EDR will be based on meeting two conditions:

1) Scoring a level to be determined on an **environmental balanced score card**, comprising six key strategic and operational environmental areas against which each of the TOs will be measured and scored

2) **Publishing an annual executive level planning statement and consulting on that statement**. This document would define and explain in clear terms what the TO has in place to meet the requirements for the transition to a low carbon system. It should highlight key themes and issues for focus. In particular it should proactively highlight emerging limitations in the transmission system and how the TO intends to address these and develop solutions. The CEO of the TO would present this document to stakeholders.

4.7. The advantage of this approach is that it is targeted to monitor and drive performance in specific areas that cannot easily be measured or incentivised through more mechanistic regimes. The scorecard will focus on aspects of performance which identify whether the TO has a systematic approach to facilitating the low carbon electricity system and that this is addressed in corporate strategy, policies and practices. We outline the proposed structure of the scorecard and the reward in more detail below.

The environmental scorecard

4.8. The aim of the environmental balanced scorecard is to integrate sustainability into the TOs' strategic development and business practices. It seeks to reward high performance in six key areas, which are outlined below, and in greater detail in Table 2.

1) Strategic understanding of and commitment to low carbon objectives and the role of the TO in their facilitation

2) Involvement in whole electricity system planning for a low carbon future including the integration with DNOs and involvement in the development of demand side interventions

3) Approach taken to connections for low carbon generators

4) Quality of innovation work and use of new ideas and results of innovation projects across the Transmission network

5) Development of approaches to demand side response and 'smarter' networks, including storage and best use of the existing network

6) Direct environmental impact of activities, and associated reporting and business greenhouse gas emissions management.

4.9. Table 2 indicates how the six key areas would be considered. Performance in each area would be assessed as "weak", "fair", "good" or "excellent". Only a performance judged as excellent would be deemed to merit a discretionary reward. For example, for key area one (strategic understanding of and commitment to low carbon objectives and the role of the TO in their facilitation) an excellent score would occur if the TO demonstrated low carbon objectives at the heart of its business strategy with a clear understanding of the commercial, operation and innovation challenges and an operational response. On the other hand, a weak score would be given if low carbon objectives were confined to generalised statements with limited integration into strategy, resource planning and operations.

4.10. Each area has a weighting which aims to reflect the relative importance of the area in the overall performance of the TO, as well as the extent to which there are other rewards available under the price control covering aspects of the behaviour being measured.

4.11. The scorecard would not remain static. We may consider moving the fair, good, excellent criteria over time. This will depend on the TOs' performance. For example an "excellent" performance in year one could be considered a "good" in future years if TOs improve their environmental performance over time. We would consult with stakeholders on any proposed change to the criteria.

Table 2: Environmental balanced scored card

Aspect of performance	Weighting*	Weak 0-24	Fair 25-49	Good 50-74	Excellent 75-100
1. Strategic understanding of and commitment to low carbon objectives and the role of the TO in their facilitation	10	Recognition of low carbon objectives confined to generalised statements with limited integration into strategy or business planning.	References to low carbon objectives within strategy but tendency to treat as 'add on' aspects of business strategy and practices rather than integral aspect.	Fully integrated understanding of how low carbon objectives influence future strategy across all activities and role company needs to play to deliver.	Low carbon objectives at heart of business strategy with clear understanding of the commercial, operational and innovation challenges and relevant scenario planning.
2. **Involvement in whole electricity system planning for low carbon future**, including integration with DNOs and involvement in development of demand side interventions	10	Focus on own investment plans and operations with only passive participation in liaison with DNOs and limited signs that DNO perspectives are shaping TO plans and operations.	Active engagement with relevant DNOs to understand their plans and share TO plans to improve potential for more integrated solutions, though still mainly operating and planning own investment as if independent.	Integrated approach to network investment planning and demand side options with DNOs and SO so that business plans of each are well informed and taking advantage of most cost-effective solutions, wherever in whole system they might be sited.	Proactive role in development of fully integrated demand forecasting and network investment planning across whole TO area, involving relevant DNOs, SO, larger demands and existing and potential generators.
3. Approach taken to **connections for low carbon generators**	5	Reactive approach to individual projects with limited attempt to take strategic perspective across range of potential future connections.	Supportive and proactive approach to individual projects but limited perspective of future project pipeline or factors influencing their likely success.	Recognised by low carbon project developers as a key partner taking an enabling role to remove barriers to connection on timely basis, within a clear strategic perspective of project pipeline.	Knowledgeable, proactive support, with TO co-ordinating developers of low carbon projects, using role to optimise system use and new investment value.

4. Quality of **innovation** work and use of new ideas and results of innovation projects across TO	10	Lack of clear innovation strategy identifying R, D & D priorities with appropriate strategic rationale. Limited attention to innovation activity by others. Poor systems for integrating new ideas. Ad hoc development of proposals to innovation fund.	Innovation strategy has priorities for R, D & D though limited range of partners and commitment to fulfil. Awareness of innovation activity by others and some examples of new ideas being successfully integrated into mainstream of business. Several proposals to innovation fund with some of sufficient quality to secure funds.	Clear innovation strategy laying out strategic reasons for innovation activities and underpinning good quality proposals to innovation fund and for effective R, D & D projects and partnerships. Actively reviewing innovation practices by others and wide range of examples of new ideas and results of innovation being integrated into business.	Clear, long-term innovation strategy tied explicitly to long-term business development and meeting future challenges on technology and cost management. Taking best from innovation by self and others and integrating quickly and effectively into business. Winning significant funds from innovation fund compared to other TOs (on basis of comparative measure).
5. Development of approaches to **demand side response** and 'smarter' networks, including storage and best use of existing network	2	Demand side intervention seen as an SO responsibility so no action.	Some consideration of demand side management (DSM) options within engagement with customers, though not actively pursued and not featuring in business planning.	Evidence from large demand customers that DSM actively considered in negotiations on contract terms and explicitly part of TO business planning in terms of options for commercial and/or operational alternatives to network investment.	As 'good' plus strong component of strategic planning, innovation interests and interaction with SO, DNOs, generators and suppliers.
6. Direct environmental impact of activities and associated reporting	2	Standard corporate environmental reporting with narrow range of aspects considered and limited understanding of	High quality environmental reporting with effective monitoring of all aspects of performance, targets	As 'fair' with steady, monitored improvement in performance and sustained efforts to improve further through benchmarking with own and other sectors.	As 'good' with environmental performance presented as key indicator of corporate performance, with benchmarking showing 'best in class' and standard setting for UK

		overall environmental impact of activities and how best to reduce.	for improvement and understanding of opportunities to improve performance.		businesses more generally.
6a.Business greenhouse gas emissions management	2	Minimal attention, justified on basis that minor part of overall carbon emissions associated with TO (and generators connected to it).	Understanding of importance of managing own carbon footprint with target, timetable and plan, though not 'on course' to meet target.	Clear carbon management plan with stretching targets and monitored programme of activities and performance 'on course' to meet target.	As 'good' plus target beyond UK national carbon budget and action within procurement to manage carbon within supply chain.

Note: DNOs = Distribution Network Operators

SO = System Operator

R, D & D = Research Design and Development

Publishing an annual planning statement and undertaking consultation on that statement

4.12. This annual report should detail planned infrastructure build and provide an assessment of environmental impacts. The report should also set out alternative options considered and provide reasons for the approaches taken. The report should include both consideration and evidence of stakeholder engagement and feedback.

4.13. Specifically the statement should report on:

- an annual public event or series of events in which the Chief Executive sets out the contents of the report and invites an assessment of environmental impacts and stakeholder feedback

- a list of all planned works, including the locations affected, the stage that the work is at (design, pre-works, planning, near construction etc) and likely dates

- the drivers for works undertaken – this should include a specific mapping of work to targets set by government and (where appropriate) specific generation/demand drivers

- the options available, including costs, timing and environmental impacts and potential mitigation

- the justification for the decision taken.

4.14. Following the consultation process, the TO would provide us with a summary of feedback received and amendments or changes made to the planning as part of the environmental measure.

Frequency and value of the EDR

4.15. We propose the EDR is awarded annually. We consider an annual award would help to raise the profile of the EDR both within the company and externally with stakeholders. It is particularly important that the businesses both develop and maintain the capacity to deliver across the requirements of the EDR scorecard and this will be best achieved through a regular and frequent process.

4.16. We propose that the EDR will be an annual process with £4 million available each year, meaning a total of up to £32 million would be available to the TO in the price control period. Half of the annual allocation can be rolled over into the next year if the full amount is not awarded.

4.17. We believe the amount of money proposed would be appropriate to encourage the desired environmental behaviour[5].

Procedures for applying for reward

4.18. We propose that TOs would apply for the discretionary reward at the end of the first financial quarter (June) outlining environmental initiatives taken in the previous financial year. The reward will recognise the initiatives taken in that previous year.

4.19. The annual statement must clearly demonstrate how the TO has met the six scorecard measures as well as discussing the topics specified in paragraph 4.12 above.

4.20. The TO would be asked to complete an environmental scorecard template (see Appendix 2) which will be the basis for the environmental balanced scorecard assessment. TOs would be obliged to respond to the questions posed in the template and the scoring will be based upon the quality of the evidence provided. We will provide additional guidance on the quality of evidence required which could result in a "weak", "fair", "good" or "excellent" score.

Assessment and Reward

4.21. We propose that a panel will provide a recommendation to the Gas and Electricity Market Authority (GEMA) for the annual allocation of the reward. We would chair the panel and appoint independent experts in addition to the Ofgem chair. This is similar to the governance structures of other discretionary rewards in previous price controls (e.g. the Gas Distribution Discretionary Reward Scheme[6]).

4.22. We would make an initial assessment of the submission, assessing if all the evidence has been provided against the relevant criteria and liaising with the TO as necessary. This assessment would input into the panel's deliberations in October of the relevant year.

4.23. Our assessment would look at past performance in the relevant period, benchmarking against other TOs. We may consider performance in the context of wider commitments to environmental initiatives and meaningful engagement with stakeholders, including future plans.

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[5] We estimate that a figure of £4 million is an appropriate incentive to recover the cost of additional resources required to meet the criteria well as well as make a reasonable return.

[6] http://www.ofgem.gov.uk/Networks/GasDistr/QoS/Documents1/Decision%20report%20for%202009.10%20Gas%20Discretionary%20Reward%20Scheme.pdf

4.24. The panel would convene in October of the relevant year to allow the panel to review our assessment, the TOs to present their submission and the panel ask any questions. The panel would then decide on the level of reward. Diagram 2 below summarises the proposed timetable for the annual reward.

Diagram 2: Timetable for awarding the EDR

	TO submits EDR application to Ofgem	Ofgem assessment to Panel after assessment of application	Panel meet to consider assessment and hear TO presentation Panel make decision
April to March	June	September	October
Financial year 1	Financial year 2		

5. Next steps

Process and timetable

5.1. We welcome views on this EDR proposal until 3 April 2012. Specifically we ask for stakeholders to respond to the questions outlined at the beginning of each chapter.

5.2. As part of the consultation process we will be holding a stakeholder workshop. This workshop will be held on 1 March, and will be an opportunity for us to further explain our thinking behind the EDR and open discussion with stakeholders. If you would like to attend, please contact jennifer.mills@ofgem.gov.uk.

5.3. Following consideration of stakeholder views, we will issue our decision on the EDR in spring 2012.

5.4. If, subject to the consideration of the consultation process, the EDR is adopted TOs would apply for the discretionary reward at the end of the first financial quarter (i.e. end of June) of the financial year outlining relevant environmental initiatives taken in the previous financial year. We would assess the TOs' EDR applications before making a recommendation to a panel of independent experts chaired by Ofgem. Any reward would be determined by October of the relevant year, so assuming a submission in June 2014, the first award would be announced in October 2014.

5.5. If the EDR is adopted, we will meet with TOs to discuss the criteria and procedures further, to ensure it is clear what is expected and by when.

5.6. To maintain the transparency of this process the panel's decision will be published on our website, outlining the reasons for making (or not making) a reward.

5.7. If the EDR is adopted we would monitor the success of the EDR. Should we feel it is appropriate to make any changes to the reward criteria, we would consult on any proposed changes.

Appendices

Appendix 1 - Consultation Response and Questions

1.1. We would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of chapter 4 and which are replicated below.

1.3. Responses should be received by 3 April and should be sent to:

Tom Handysides
Sustainable Energy Policy
Ofgem
9 Millbank
London
SW1P 3GE
020 7901 7289
tom.handysides@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in our library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. We shall respect this request, subject to any obligations to disclose information, for example under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document(s) to that effect and include the reasons for confidentiality. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. It would be helpful if responses could be submitted electronically.

1.7. Having considered the responses to this consultation, we intend to publish our decision on the EDR in spring 2012. Any questions on this document should be directed to: tom.handysides@ofgem.gov.uk

Question 1: Do you agree it is appropriate to have an EDR?

Question 2: Do you support the proposed environmental balanced scorecard?

Question 3: Are we asking the right questions in the balanced scorecard reporting template we are asking Transmission Owners (TOs) to complete?

Question 4: **Do you support the proposed requirement for TOs to publish an annual report on what they have in place to meet the requirements for the transition to a low carbon system?**

Question 5: **Do you believe the proposal would be effective in driving TOs towards facilitating low carbon energy?**

Question 6: **What is your view on the standards to be met to receive the reward and do you believe the level of the reward is appropriate?**

Question 7: **Do you believe the outlined timetable for making the reward is appropriate?**

Appendix 2 – TO submission template for the environmental score card

Aspect of performance	Weighting	Questions to complete (maximum 500 words per question)	Evidence Required
1) Strategic understanding of and commitment to low carbon objectives and the role of the TO in their facilitation	10	a) How is your company responding to the challenge of developing a low carbon electricity system? b) Where do you consider your company is falling short and could improve its performance? c) What plans do you have to improve performance?	TO regulatory reporting TO submission to EDR process
2) Involvement in whole electricity system planning for low carbon future, including integration with DNOs and involvement in development of demand side interventions	10	a) How does your company ensure its plans are set within an integrated whole system planning approach? b) What do you see as the key barriers to progress on whole system planning? c) What steps is your company taking to address these barriers?	TO submission to EDR process Specific details on any joint ventures or initiatives with others. Responses by DNOs, SO and others in customer satisfaction survey

3) Approach taken to **connections for low carbon generators**	5	a) What steps is your company taking to enable the connection of low carbon generation? b) How are you addressing the different needs of different developers of low carbon generation projects? c) What are you planning to improve about this aspect of your company's work, and why?	Subset of questions on customer survey and connections data TO submission to EDR process
4) Quality of **innovation** work and use of new ideas and results of innovation projects across TO	10	a) Give examples of how your company has applied the results of innovation projects which (i) it has initiated and (ii) it has learned from others b) What did you learn from your innovation work and how has this affected your innovation strategy? c) How has this learning changed your business plans and/or practices and how are you measuring this impact?	TO submission to EDR process Comparative measure of £ of funding won under innovation fund per £ turnover measure £R, R & D expenditure per £ turnover
5) Development of approaches to **demand side response** and 'smarter' networks, including storage and best use of existing network	2	a) What is your company doing to develop demand side responses and other interventions to make the most of the existing network and bring about a 'smarter' network? b) What challenges is your company facing in achieving these goals? c) How is your company addressing these challenges and what will change if you succeed?	TO submission to EDR process Results of customer survey asking if demand side response is ever a factor in discussions on connections/services

6) Direct environmental impact of activities and associated reporting	2	a) Which environmental impact are you finding hardest to manage in line with your policies and what are you doing to address this challenge?	TO annual environmental report TO submission to EDR process, detailing full Eco-Management and Audit Scheme outputs[7], targets etc
6a) Business greenhouse gas emissions management	2	a) What are the main challenges your company faces in cutting greenhouse gas emissions and how are you addressing these?	Business Carbon Footprint report to Ofgem TO EDR submission detailing progress against targets and review of plans

[7] The Eco-Management and Audit Scheme is a voluntary environmental management instrument developed by the European Commission.

Appendix 3 - Glossary

C

Carbon intensity

The amount of carbon by weight emitted per unit of energy consumed.

Carbon Reduction Commitment Efficiency Scheme

The CRC Energy Efficiency Scheme (previously known as the Carbon Reduction Commitment) is a mandatory carbon emissions reporting and pricing scheme to cover all organisations using more than 6,000MWh of electricity per year.

D

Demand side response

A demand side response is a short-term change in the use of electricity or gas by consumers following a change in the balance between supply and demand.

E

Eco Management and Audit Scheme

The Eco-Management and Audit Scheme is a voluntary environmental management instrument developed by the European Commission.

G

Gas and Electricity Markets Authority (GEMA)

GEMA is the governing body of Ofgem and consists of non-executive and executive members and a non-executive chair. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

Gone Green scenario

One of three scenarios set out by National Grid envisaging how energy supply and demand may look under various circumstances. There were created as part of a review of the strategic transmission investment needed to meet the UK’s 2020 renewable energy target.

L

Licence requirements

Ofgem considers gas and electricity licence applications and decides whether or not to grant a licence in accordance with our published objectives and non-discriminatory criteria and procedures. The licences are an obligation placed on the network companies to meet certain standards of performance. GEMA has the power to take appropriate enforcement action in the case of a failure to meet these obligations.

P

Price control

Price controls set the maximum amount of revenue which energy network owners can take through charges they levy on users of their networks to cover their costs and earn them a return in line with agreed expectations.

R

RIIO (Revenue = Incentives + Innovation + Outputs)

Ofgem's new regulatory framework, stemming from the conclusions of the RPI-X@20 project, to be implemented in forthcoming price controls. It builds on the success of the previous RPI-X regime, but better meets the investment and innovation challenge by placing much more emphasis on incentives to drive the innovation needed to deliver a sustainable energy network at value for money to existing and future consumers.

RIIO-T1

The price control review being applied to the electricity and gas transmission network operators, following the TPCR4 rollover. This price control will run from 1 April 2013 and will be the first transmission price control review to reflect the new RIIO regulatory framework.

T

Transmission

The networks of high voltage electricity wires and high pressure long distance gas pipelines which convey electricity and gas from power stations and offshore facilities to industrial consumers and to the local distribution networks.

Appendix 4 - Feedback Questionnaire

1.1. Consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand? Could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments.

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk