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Date: 21 November 2019

Dear Colleague,

Decision on the RIIO-T1 Environmental Discretionary Reward Scheme 2018-19 – Electricity Transmission Licensees

This letter sets out the decision of the Authority¹ on the Environmental Discretionary Reward (EDR) scheme for the 2018-19 scheme year of the RIIO-T1 price control period.

The purpose of the EDR scheme is to sharpen the focus of the companies on strategic environmental considerations and organisational and cultural changes to facilitate growth in low carbon energy, for example encouraging a more systematic approach to whole system planning. The scheme is a reputational and financial incentive available to Scottish Hydro Electric Transmission Plc (SHE Transmission), SP Transmission Ltd (SP Transmission) and National Grid Electricity Transmission Plc (NGET) (the licensees).

Unlike previous years, this year the scheme takes account of NGET's transmission network owner role only. This is to acknowledge the separation of NGET's ESO functions to National Grid Electricity System Operator Limited (NGESO). We note that legal separation did not enter into force until 1 April 2019, but our view is that separation would create practical difficulties to the preparation and assessment of a joint TO/ESO submission for the 2018-19 scheme year. We have also taken into account that the ESO will be governed by the ESO incentive scheme for the 2018-19 scheme year. The ESO scheme provides strong incentives to ensure the ESO is playing its part in the low carbon transition.

¹ The terms "we", "us", "Ofgem" and "the Authority" are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

The EDR incentive scheme has an annual value of £4m plus any applicable rolled-over amounts from previous years. We may award all, some or none of the incentive each scheme year. The total financial reward available for the 2018-19 scheme year is £6m, as £2m was rolled over from last year. Only companies that have a satisfactory executive level annual statement (ELAS) and achieve leadership on the balanced scorecard are eligible for a financial reward.

Following our assessment this year, the Authority has decided to award £1m to SHE Transmission, and £1m to SP Transmission. The remainder of this letter sets out the detail behind this decision.

The assessment process

The EDR guidance sets out the assessment process for this scheme². Applications are assessed by Ofgem, and strategic challenge of the assessment is provided by a panel of independent experts. The panel then holds a question and answer session with each company, followed by a feedback session where the panel express views on how the companies can improve.

The EDR application is in two parts. The first part is an ELAS that has been published by the company, and has been subject to consultation. This identifies the strategic activities related to the EDR scheme which the company will undertake over the next three years. A satisfactory statement will identify the drivers for strategic initiatives, provide information on their status, assess sustainability impacts, describe stakeholder involvement and justify decisions.

The second part is an assessment of the evidence provided by the company against the requirements of the category questions. The categories and the relative weighting for each category are shown in the table below.

The scorecard categories

	Category name	Category weighting
1	Strategic understanding and commitment to low carbon objectives	21%
2	Whole electricity system planning	21%
3	Connections for low carbon generators	21%
4	Collaboration on innovation	11%

²[Guidance document for the Environmental Discretionary Reward scheme](#)

5	Network development solutions that avoid the need to reinforce the network	11%
6	Direct environmental impact	11%
7	Business greenhouse gas emissions	4%

To demonstrate the company's performance against each category, several evidence criteria have to be met. Following submission, we assess the evidence and awards points if the criteria are met.

Each category of the scorecard is weighted as indicated above, and the result is an overall percentage score. Performance is then ranked in a band according to these scores. The three performance bands are:

Percentage range	Performance band
<50%	Engaged
50-70%	Proactive
≥70%	Leadership

Only companies that have a satisfactory statement and a Leadership score are eligible for a financial reward. The process for determining the reward is set out in the guidance document.

Submissions and panel

All transmission licensees applied to the scheme for the 2018-19 scheme year.

Following Ofgem's assessment of the submissions using a balance scorecard approach, the companies were invited to attend the expert panel session which was held on 19 September 2019. The panel members are chosen for their expertise and experience in low carbon and environmental issues:

- Charlotte Friel, Head of RIIO Transmission Policy (non-voting Ofgem Chairperson)
- Ruth Chambers, Public Policy Specialist
- David Grantham, Environmental Management Consultant
- Jiggy Lloyd, Sustainability Adviser
- Loretta Boman, Independent Consultant.

Following question and answer sessions with representatives from each of the licensees about how each licensee is meeting the aims of the EDR scheme, the panel confirmed the

results for each licensee, as outlined in the table below. We provide more details on individual licensee performance in the remainder of this letter.

Results of the Environmental Discretionary Reward for the 2017-18 scheme year

Licensee	Annual statement	Score and performance band	Financial reward
SHE Transmission	Satisfactory	78% - Leadership	£1m
SP Transmission	Satisfactory	78% - Leadership	£1m
NGET	Satisfactory	63% - Proactive	None

Executive level annual statement (ELAS) assessment

The assessment team considered that the ELAS of each of the three licensees met the requirements and was satisfactory.

Balanced scorecard assessment

We indicate below in broad terms where each licensee has been most successful. We also highlight some aspects of the EDR submissions each licensee needs to address to improve its EDR score in future.

This year, the panel again encouraged all licensees to focus on improving their quality assurance (QA) processes. The Panel appreciate that evidence is gathered from a wide range of personnel and would encourage a wider-spread company understanding of the basic requirements for evidence (dates, names, applicability, etc). Despite this there was a noticeable improvement in the quality of evidence where the specific *transmission* contribution had been identified, as opposed to group-level activity.

The Panel specifically noted that Categories 2 and 5 were a challenge this year, particularly in the treatment of activities that were relatively new in previous years but have rapidly become common practice. The Panel reiterated that the aim of the EDR is to demonstrate Leadership in these areas, and so encourage companies to consider how best to demonstrate 'clear blue water' between one year's performance and the next.

In general, the Panel considered that companies' strategic goals are not always translating into action on the ground, and activities on the ground are not always visibly informing strategy development. For next year, the Panel recommend looking for stronger evidence that strategy influences choice of projects, and projects overseen by senior management are assessed against the strategy. This approach could be supported by more evidence showing use of data and analysis, and increased use of digitalisation as a concept to support internal development.

Scottish Hydro Electric Transmission

For the second year in a row, SHE Transmission have achieved an overall 'Leadership' score.

By category, SHET achieved a Leadership score in five categories: 'strategic understanding', 'whole system planning', 'connections', 'innovation', and 'non-GHG environmental issues'. It obtained a Proactive score in 'business greenhouse gases', and an Engaged score in 'network development approach'.

SHET scored highly for elements of strategic understanding across all topics, with a substantial improvement on last year's score. Much of this improvement is attributable to better evidence around use of resources (particularly transmission specific rather than group level). Also, much stronger evidence was provided on the regularity and reach of their stakeholder communication, and on the systemic nature of their benchmarking and reporting.

The company has found it more challenging to identify evidence that shows it has taken a leadership role in such business as usual (BAU) activities as the Networks Options Assessment, Future Energy Scenarios, or changes to the System Operator Transmission Owner Code. In a similar vein, evidence for taking a leading role in activities with a wider range of collaborators could have been stronger and more substantial. The Panel also noted that, for the criteria of demonstrating alternatives to traditional reinforcement activities, SHET provided insufficient evidence that 'non-build and alternative network development' solutions had been considered in the decision-making process.

The Panel recommended that SHET look more closely at the provision of evidence for actual performance improvement, as well as the internal re-organisation and decisions intended to lead to such improvement. The Panel looked forward to seeing the impact of the focus on sustainability in procurement practices in next year's submission, as well a transmission-only GHG reduction target.

SP Transmission

SPT have achieved a 'Leadership' score, an improvement on last year's 'Proactive' result.

By category, SPT achieved a Leadership score in five categories: 'strategic understanding', 'connections', 'innovation', 'network development approach', and 'business greenhouse gas emissions'. It obtained a Proactive score in the 'non-GHG environmental issues' category, and an Engaged score in the 'whole system planning' category.

SPT provided much more effective evidence on Board involvement in annual reviews of strategy, which had been missing the previous year. Linked to this point was the addition of evidence articulating the analysis and response to UK low carbon policies on its business, with ample evidence showing regular senior management review of analysis, activities, strategy, and forward planning changes.

SPT did not demonstrate leading activities in BAU processes, such as NOA, similar to SHET. The Panel commented that where engagement with third parties was highlighted, evidence tended to rely on inputs (e.g. invitations, lobbying), rather than outputs (e.g. reductions in regulatory or commercial barriers). The Panel commended, however, SPT's evidence for innovation activities where SPT had provided evidence that collaborators' views had been incorporated into activities, not just collected.

Overall, the Panel considered that the demonstration of systemic changes was particularly strong, whether migrating innovation to BAU, processes for stakeholder engagement, or a new quality assurance system for emissions analysis. The Panel also commended the evidence demonstrating a reduction in its controllable greenhouse gas emissions compared to the base year.

The Panel recommended that SPT may like to focus more on demonstrating corporate responsibility in roles for environmental issues, and an increased focus on a strategy for environmental issues in their procurement processes, including identifying where the transmission business, rather than the group, is leading.

National Grid Electricity Transmission

NGET have achieved an overall 'Proactive' score, the same result as last year.

By category, NGET achieved a Leadership score in four categories: 'strategic understanding', 'innovation', 'non-GHG environmental issues', and 'business greenhouse

gas emissions'. It obtained a Proactive score in the 'connections' category, and an Engaged score in the 'whole system planning' and 'network development approach' categories.

The panel were pleased that NGET had scored better in strategic understanding issues than the previous year, noting that evidence was much stronger for key business decisions, activities, and the subcommittee process that reports on strategy to the Board.

The Panel noted that NGET didn't score as well for their work on whole system planning, mainly due to (as last year) not providing sufficient evidence that there was a single point of overall responsibility at senior management or Board level for whole system planning, or referring only to BAU tasks such as engaging in NOA. NGET also did not provide strong enough evidence that external users' information and scenarios were used to inform network development or whole system planning. Similarly, the Panel noted that NGET had insufficient evidence for engaging with third parties on innovation outside of the Ofgem NIC and NIA schemes.

The panel commended NGET for their evidence on wider environmental issues, where evidence was comprehensive and effective. NGET should consider providing more evidence of transmission-specific application of sustainable procurement practices, however, as much of its evidence related to the group level activity.

Lastly, the panel noted the good evidence provided on greenhouse gas emissions, particularly regarding methodology, targets, management and external verification. However, the progress made on overall GHG reductions was outweighed by leakage of SF6 gas from a single asset on the system, so NGET were not able to gain points for actual reductions performance.

Ofgem decision on financial rewards

In our guidance, we indicate that a Leadership company will look beyond conventional approaches, take a whole system perspective, and collaborate with a range of stakeholders to implement new thinking. Based on the scoring by our assessment team and discussion with the licensees' representatives, the panel concluded that SHE Transmission and SP Transmission had demonstrated this.

Following its recommendation, and in line with the scheme guidance in which a licensee with a score between 70% and 79% receives up to a third of the potential maximum payment, we have decided to award £1m to SHE Transmission and £1m to SP Transmission.

This decision sets the value of the EDROt term for 2018-19 under Special Condition 3F. The money awarded to SHE Transmission and SP Transmission under this incentive, with appropriate interest adjustments, will adjust the amount of the Output Incentive Revenue Adjustment term, to reflect performance in relation to the EDR. This adjustment will be reflected in the 2020-21 Allowed Transmission Owner Revenue, as derived under Special Condition 3A.

We consider that all three licensees have scope to make further progress in meeting the EDR scheme's aims and providing evidence that links well to the EDR criteria. We hope that the reward this year will motivate all three TOs to continue improving their performance and demonstrate this successfully in their applications.

As the value of the reward allocated in the 2018-19 scheme year amounts to £2m from a maximum potential payment of £6m, this leaves an unallocated amount of £4m. As up to half of the total available annual funding can be rolled over to the following year, the maximum available reward for the 2019-20 scheme year will again be £6m.

Next steps

We continue to keep the EDR scheme under review and welcome any feedback on how it is operating. If you have any queries about this letter, please contact Joanna Gaches at Joanna.Gaches@ofgem.gov.uk.

Yours faithfully,

Min Zhu
Deputy Director, Systems and Networks, Transmission