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Dear Tom,

Environmental Discretionary Reward under the RIIO-T1 price control

On behalf of Scottish Hydro Electric Transmission Ltd (SHETL), I am writing in response to the consultation on the Environmental Discretionary Reward (EDR).

As set out in our Business Plan (published in July 2011), our January 2012 Update and previous responses to the RIIO-T1 team, we welcome and support Ofgem's increased focus on the environment. Sustainability is one of our core values and we are committed to developing meaningful measures in relation to our environmental performance that allow our stakeholders to understand and contribute to the impacts of our activity.

In summary, we are supportive of the principles that underpin the EDR but believe further work is required to ensure that the mechanism delivers an outputs-based approach, where recognition is based on achieving outcomes that reflect the potential contributions that the TOs can make, rather than promoting particular approaches. We believe it is achievable to complete this further work in order to enable implementation from 1 April 2013 and are committed to working with Ofgem on further development of the mechanism, as appropriate, to achieve this.

Our responses to the questions posed in the consultation paper are provided in the following pages. This response has also been informed by our participation in the workshop held by Ofgem last month which provided increased clarity on some of the areas covered by the proposed EDR. If you have any questions in relation to any aspect of this response, please feel free to contact me on the number provided.

Yours sincerely,

Jen Carter
Networks Regulation

Q1: Do you agree it is appropriate to have an EDR?

As set out in our Business Plan (published in July 2011), our January 2012 Update and previous responses to the RIIO-T1 team, we welcome and support Ofgem's increased focus on the environment. Sustainability is one of our core values and we are committed to developing meaningful measures in relation to our environmental performance that allow our stakeholders to understand the impacts of our activity.

We therefore see merit in Ofgem's proposal to have a mechanism that recognises and rewards environmental performance by the TOs, subject to such a mechanism being commensurate with our role as a regulated body, our activities and consumers' expectations of what we can/should deliver. Unlike some parties in the industry, we do have a number of statutory duties that set the context against which these proposals should be considered, including our duties under Schedule 9 of the Electricity Act 1989. In addition, but also relevant, we have a duty to not discriminate between parties, as well as a duty to develop and maintain an efficient, co-ordinated and economical system of electricity transmission.

Hence, the EDR should be underpinned by consumers' expectations and our statutory duties, and then reward real outcomes. For example, the EDR should not prescribe current best practice ('an input') but rather prescribe the areas in which innovative TOs can deliver environmental improvements through our processes and activities, at a cost that is acceptable to our stakeholders.

In our view, further work is required to refine the mechanism to ensure it delivers an outputs-based approach, where recognition is based on achieving outcomes that reflect the potential contributions that the TOs can make, rather than promoting particular approaches.

Q2: Do you support the proposed environmental balanced scorecard?

We welcome the use of the proposed scorecard (or a variation of) to provide clarity on the hurdle level required to be considered for the EDR. As set out in response to Q3, we believe some of the aspects of performance and associated criteria need further consideration.

We believe that mechanisms of this nature are only effective where any interested party can understand the scoring system and, at present, believe that further work is required to clarify how scores will be calculated and then how they will feed into the recommendation to the Panel.

We note, for example, that "*only a performance judged as excellent would be deemed to merit a discretionary reward*" but are unclear whether excellent performance is required in each and every component or as an assessment of overall performance. We suggest that there may be outcomes where a performance rating of 'excellent' is required to progress to consideration by the Panel but suggest that a rating of 'good' may be acceptable for other outcomes, in conjunction with a certain number of areas rated as 'excellent'. We would also appreciate further clarity on how the weighting is intended to be used as this seems to only be needed if the EDR is reflecting overall performance.

Q3: Are we asking the right questions in the balanced scorecard reporting template we are asking Transmission Owners (TOs) to complete?

We are concerned that some of the proposed criteria veer out of the remit of the TOs into the responsibilities of other parties (predominantly, but not limited to, those of the System

Operator). We believe it is essential that all of the TOs should be able to achieve excellent performance and therefore suggest that some of the criteria need to be revised to ensure they do not result in any unintentional consequences.

We urge Ofgem to define the aspects of performance as an outputs-based approach; making clear the outcomes that the mechanism is intended to deliver but not prescribing how these are to be achieved. We believe such an approach will ensure the mechanism is able to endure throughout the period, with minimal requirement for change as best practice evolves, as well as reflecting the differences in the participating TOs.

To ensure this proposal delivers the maximum benefit for consumers, we suggest that there needs to be sufficient scope within the performance aspects to recognise and reward all contributions to environmental performance. The proposed scorecard does not appear to capture contributions beyond the six performance areas which may result in some areas of activity not being captured by the mechanism.

Q4: 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?

As set out in our Business Plan (published in July 2011) and January 2012 Update, we envisage increased communication between SHETL and our stakeholders across the T1 period. We have set out our commitment to consult on our draft stakeholder engagement strategy this summer and are keen to ensure that the approach and method/s that we adopt are consistent with the feedback that we receive through this process.

Whilst we support a minimum requirement throughout T1 for TOs to publish at least an annual update to stakeholders, we are concerned that the proposal to publish an annual planning statement (as set out on p.23 of the consultation document) is overly prescriptive. It also has the potential to limit our ability to provide information to and/or seek feedback from our stakeholders in a manner that reflects their response to our consultation. Ofgem should therefore provide guidance on areas that TOs might want to cover, rather than a template. We would expect the information provided to be relevant to stakeholders, as reporting to Ofgem on environmental outputs within the price control will presumably be captured within the RRP.

Q5: Do you believe the proposal would be effective in driving TOs towards facilitating low carbon energy?

As set out in our Business Plan, published in July 2011, and January 2012 Update, we are committed to expanding our network to facilitate the growth of renewable generation in the north of Scotland and recognise our role in facilitating the transition to a low carbon economy. We believe this proposal will promote and encourage best practice throughout the T1 period, e.g. innovation driving timely delivery.

However, as set out above, we do have a duty to not discriminate in our activities are concerned about components of the scorecard potentially favouring one group over others. Whilst we recognise the intent behind this, we suggest careful wording is required to not result in a measure that conflicts with our statutory duties.

Q6: 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?

We recognise that the standards are intended to act as 'stretch targets' and, as such, it is appropriate that the criteria requires the TOs to go beyond 'business-as-usual' performance (i.e. what is assumed in the Business Plan). However, it is essential that the criteria are achievable and the costs in achieving the excellent level are proportionate to the benefits derived by consumers and in line with our duties to develop and maintain the network in an efficient and economic manner.

Q7: Do you believe the outlined timetable for making the reward is appropriate?

We recognise the need for the Panel to be able to review the initial assessment and make a decision in sufficient timeliness for the Authority to be able to determine in sufficient time for the reward to be able to feed into the annual iterative process for the financial model. However, we suggest that the further consideration is required on the timetable for the TOs to submit evidence to Ofgem, ahead of the Panel's consideration and any subsequent Authority determination awarding the EDR, given the potential overlap with internal reporting requirements for the RRP and other returns compiled by the TOs and submitted to Ofgem.