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## **Decision on the RIIO-T1 Environmental Discretionary Reward Scheme 2014-15 – Electricity Transmission Licensees**

This letter sets our decision on the Environmental Discretionary Reward (EDR) scheme incentive in the 2014-15 scheme year of the RIIO-T1 price control period.

The EDR scheme is a reputational and financial incentive for electricity transmission licensees operated by the Gas and Electricity Markets Authority (the Authority). It also takes account of National Grid's dual role as both Transmission Owner (TO) and System Operator (SO). The purpose of the EDR scheme is to sharpen the companies' focus on strategic environmental considerations and organisational and cultural changes to facilitate growth in low carbon energy.

The EDR scheme has a standard annual financial reward of up to £4m across all applicants. In addition, it allows up to 50% of the unallocated funds from the previous year to be added to this. Therefore, the total financial reward available in 2014-15 is £6m, i.e. £4m plus £2m which is carried forward from the first scheme year, as no company received a reward then.

### **The assessment process**

Our EDR guidance sets out the assessment process for this scheme.<sup>1</sup> Applications are initially assessed by Ofgem. Strategic oversight of the assessment is provided by a panel of independent experts, chaired by Ofgem, which involves a question and answer session with each company.

Two elements of an EDR application are assessed. First, an executive-level annual statement that has been published by the company and has been subject to consultation. This identifies the strategic activities that the company will undertake in the next three years which relate to the EDR aims. 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 element of the assessment is the company's evidence against the requirements of a balanced scorecard.

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<sup>1</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/edr\\_guidance\\_revision\\_2\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/edr_guidance_revision_2_0.pdf)

The scorecard had seven categories:

1. Strategic understanding and commitment to low carbon objectives
2. Whole electricity system planning
3. Connections for low-carbon generators
4. Collaboration on innovation
5. Network development solutions that avoid the need to reinforce the network
6. Direct environmental impact
7. Business greenhouse gas emissions

To demonstrate the company's performance against each category several evidence criteria have to be met. The number of criteria varies from 6 to 20 according to category, totalling 86 in all. Following submission, we assess the evidence and awards points if the criteria are met.

Each category of the scorecard is weighted and the result is an overall percentage score. Performance is rated using these scores: 'engaged' (0 to 49%), 'proactive' (50% to 69%), or 'leadership' (70% plus). Only companies that have a satisfactory statement and a leadership score overall are eligible for a financial reward. The process for determining the reward is set out in the guidance document.

### **The submissions and the panel session**

In the 2014/15 scheme year all three licensees (National Grid Electricity Transmission Plc (NGET), Scottish Hydro Electric Transmission Plc (SHE-T), and Scottish Power Transmission Ltd (SPT)) applied to the scheme.

Scoring was completed and the companies were invited to attend the panel session on 11 September 2015.

This year's panel was made up of experts chosen for their expertise and experience in low carbon and environmental issues:

- Dr Stephen Bass, Head of Delivery, Consumers and Sustainability, Ofgem (non-voting Chair)
- Loretta Boman, Director, Energy Advisory, Advisian/Worley Parsons
- Ruth Chambers, Public Policy Specialist
- David Grantham, Environmental Management Consultant
- Jiggy Lloyd, Sustainability Adviser
- Simon Roberts, Chief Executive at the Centre for Sustainable Energy.

Following questioning of representatives from each company about how the company was meeting the aims of the EDR scheme, the panel confirmed the assessment teams scores.

### **Results of 2014-15 Environmental Discretionary Reward**

Company	Annual Statement	Performance band	Financial Reward
<b>NGET</b>	Satisfactory	Leadership	£2m
<b>SHE-T</b>	Satisfactory	Proactive	None
<b>SPT</b>	Satisfactory	Engaged	None

## **Detail**

As required, each company consulted on its annual statement by publishing it on its website. This year, there were no formal responses but some companies obtained subsequent informal feedback. The absence of formal responses is disappointing, as it does not allow us to take a view on what stakeholders think of each company's strategy. The executive level annual statements are an important description of the strategic direction the companies are taking and the importance they accord to the low carbon transition.

The assessment team and the EDR panel considered that the executive-level statements were satisfactory.

Achieving a good overall score on the scorecard requires that high scores are achieved in each category, but in particular those that have greatest weight. We indicate below in broad terms where each company has been most successful. We have also provided a few examples to highlight what led us to award points and what didn't.

### NGET

NGET demonstrated leadership performance in categories 1 (Strategic Understanding), 4 (Innovation), 5 (Network development), 6 (Direct environmental impact) and 7 (Greenhouse gases). Of these, category 1 had the highest weight. Here NGET showed, for example, that it had a clearly defined strategy at group level, with strong linkage into management, including procurement. Its business targets for carbon reductions were also well defined.

Another example of good evidence was in category 4 (innovation) where evidence showed a number of key innovation managers within NGET. However it would be helpful for it to demonstrate more evidence in the areas of system planning and connections for low carbon generators.

### SHE-T

SHE-T's scorecard has improved overall from last year. It demonstrated leadership performance in 1 (Strategic Understanding), 4 (Innovation), 6 (Direct environmental impact) and 7 (Greenhouse gases). An example of the good evidence provided by SHE-T was about drivers for its strategy. Here it referred to reports from the Committee on Climate Change on progress in reducing emissions in Scotland and this is clearly relevant. We were also impressed by the clarity of its guidance on connections. Categories 2, 3 and 5 were below the leadership threshold.

The EDR panel questioned the companies' representatives on aspects of its performance on EDR objectives. The panel considered that, in relation to the scheme aims, too much emphasis was being placed on what might be described as business as usual activities. However, progress towards the leadership category had been made in the current year.

### SPT

The scorecard for SPT did not demonstrate the improvement that may have been expected. Indeed, because of relatively low scores in some important categories the overall assessment slipped from 'proactive' last year to 'engaged' this year. Only category 6 (Direct Environmental Impact) was in the leadership band. An example of good evidence provided by SPT was about the company's interaction with the SO, the connecting party and other relevant stakeholders (with emphasis on what is beyond business as usual). Briefing notes were provided on joint connections into Coalburn substation that demonstrated the interactions sought by the criteria.

Generally, the relationship between the submitted evidence and the precise criteria was often not drawn out sufficiently. For example, a sustainability committee was recently established by SPT and for some criteria this was used as the sole evidence, but at this point its impact is not clearly defined. The EDR panel welcomed its creation but following more detailed discussion with company representatives considered that in this particular year its impact on EDR objectives had not been demonstrated.

### **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 its questioning of the company representatives, the EDR panel concluded that NGET had demonstrated this. Following its recommendation, and in line with the scheme guidance in which a sole leadership company with a score between 70 and 79% receives up to one third of the amount available, we have decided to make a reward of £2m to NGET.

The money awarded to NGET under this incentive will adjust the amount of the Output Incentive Revenue Adjustment term, to reflect the licensee's performance in relation to the EDR. This adjustment will be applied to the 2016-17 revenues.

We consider that all three companies 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 them to achieve more and demonstrate this successfully in their applications.

As we made a financial reward of £2m from a pot of £6m, this leaves an unallocated amount of £4m. As half of the unallocated amount to roll over to next year the maximum reward for 2015-16 will be £6m, as it was this year.

### **Next Steps**

We continue to keep the EDR scheme under review and welcome any feedback on how it is operating. Any changes will be reflected in the EDR guidance document for the next scheme year.

We look forward to the next round of the EDR scheme and receiving applications for the 2015-16 scheme year by 30 June 2016.

If you have any queries about this letter please contact Harvey Beck at [harvey.beck@ofgem.gov.uk](mailto:harvey.beck@ofgem.gov.uk) or on 020 7901 7088.

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