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for energy consumers

Direct Dial: 020 901 7000

Email: [Min.Zhu@ofgem.gov.uk](mailto:Min.Zhu@ofgem.gov.uk)

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Dear Colleague,

## **Decision on the RIIO-T1 Environmental Discretionary Reward Scheme 2019/20 – Electricity Transmission Licensees**

This letter sets out the decision of the Authority<sup>1</sup> on the Environmental Discretionary Reward (EDR) scheme for the 2019-20 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).

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 2019-20 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 £2m to each of the transmission owners (TOs) - SHE Transmission, NGET, and SP Transmission. The remainder of this letter sets out the detail behind this decision.

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<sup>1</sup> 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 assessment process

In response to the impact of the Covid-19 pandemic we published a summary of amendments to the RII0-1 network price control processes for 2020<sup>2</sup>, which included some changes to the annual regulatory reporting arrangements. As a result, we departed from the assessment process set out in the EDR guidance for this scheme<sup>3</sup>. The key difference is that we did not convene the expert panel or the panel day. That was because the timings of our assessment had to be flexible to fit around the work areas we had re-prioritised in response to the pandemic, which meant it was difficult to commit to a fixed schedule.

As a result, the assessment for the 2019/20 EDR consisted of Ofgem's review of submissions, using a balance scorecard approach, with any outstanding queries resolved through a supplementary question process with the TOs.

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

<sup>2</sup> [https://www.ofgem.gov.uk/system/files/docs/2020/05/covid-19\\_-\\_updated\\_riio-1\\_work\\_programme\\_-\\_final\\_may\\_2020.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/05/covid-19_-_updated_riio-1_work_programme_-_final_may_2020.pdf)

<sup>3</sup> [Guidance document for the Environmental Discretionary Reward scheme](#)

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 ELAS and achieve Leadership against the scorecard criteria are eligible for a financial reward. The process for determining the reward is set out in the guidance document.

### ***Submissions***

All transmission licensees applied to the scheme for the 2019-20 scheme year.

Ofgem assessed the submissions using the scorecard approach. The assessment results for each licensee are summarised in the table below. More details on individual licensee performance is set out in the remainder of this letter.

### **Results of the Environmental Discretionary Reward for the 2019-20 scheme year**

Licensee	Annual statement	Score and performance band	Financial reward
SP Transmission	Satisfactory	99% - Leadership	£2m
SHE Transmission	Satisfactory	97% - Leadership	£2m
NGET	Satisfactory	96% - Leadership	£2m

## ***Executive level annual statement (ELAS) assessment***

We considered that the ELAS of each of the three licensees met the requirements and was satisfactory.

## ***Scorecard assessment***

We indicate below in broad terms our findings from this year's assessment. We then highlight for each licensee where it has been most successful, as well as some aspects that each licensee should continue to work on for the final RIIO-ET1 EDR submission later this year.

All of the TOs performed very well against the EDR criteria for the scheme year 2019/20, with each TO achieving their highest leadership score to date in RIIO-T1. The step change in performance can be explained by three key factors. The first is that many of the activities that the TOs undertook in 2019/20 for their RIIO-2 business planning programme are closely aligned to the EDR categories. The second is that the TOs introduced several new ways of working or made adjustments to existing processes in 2019/20 to better align their working practices to the energy transition challenges and opportunities. The third factor contributing to the better EDR performance was the improved quality of the submissions that met the basic requirements for evidence overall.

From their RIIO-2 business planning activities in the scheme year, each TO provided good evidence that it has embedded the decarbonisation agenda into its transmission business planning. We saw good examples of robust strategy development for decarbonisation of the energy sector, high levels of senior management engagement on low carbon objectives and business decisions taken to contribute to the low carbon transition. Each of the TOs also had strong evidence of how they had responded to stakeholder engagement on these issues, and had adjusted plans accordingly.

A notable improvement in the 2019/20 submissions compared to last year, was the evidence given in Categories 2 (whole systems) and 5 (non-conventional network development). In several cases, the TOs showed how they had adopted new approaches, introduced new activities and/or built on existing activities to embed whole systems thinking and consideration of non-conventional solutions into business decisions. We saw evidence of explicit accountability being given at both working and senior management level for these objectives, integration within the company's optioneering processes, as well as systematic collection of information from other parts of the energy system eg gas, hydrogen, to inform network planning.

It was also apparent that all licensees have acted on advice from the panel last year to continue to improve their quality assurance (QA) processes of the submitted application. This is the first year that none of the three TOs missed points because of failure to meet the basic requirements for evidence (dates, names, applicability, etc).

The results for the 2019/20 scheme year mark a high point in the EDR, suggesting that it has been effective in both identifying the likely challenges and opportunities of the energy transition, as well as reinforcing the adoption of behaviours and cultural changes by the TOs that is needed to tackle these. However the high level of leadership achieved this year does not mean that the TOs can take their eye off the ball in the final year of RIIO-T1. The EDR's aim is that the TOs continue to demonstrate leadership in these areas, therefore it is important that all the companies build on their efforts to date and show that there is 'blue water' between the evidence provided for the 2020/21 scheme year and that submitted for the 2019/20 scheme year.

### ***SHE Transmission***

For the third year in a row, SHE Transmission has achieved an overall leadership score. However, this was the first year that they achieved leadership in all seven categories: 'strategic understanding', 'whole system planning', 'low carbon connections', 'innovation', 'non-conventional solutions', 'direct environmental impact' and 'business greenhouse gas (GHG) emissions'.

SHE Transmission significantly improved its performance in the Category 5 non-conventional solutions category on last year's score. This was clear from the evidence submitted, which included a formal check-point in its optioneering processes to challenge whether non-conventional options were duly considered; several examples of non-conventional projects sanctioned in the scheme year; and the introduction of a new team working across the organisation on non-conventional solutions.

Other areas where SHE Transmission made significant improvements compared to last year, were Categories 3 (low carbon connections) and 7 (business GHG emissions). The improvement in the latter category was due to it being on track to meet its RIIO-T1 business carbon footprint (BCF) target, and externally reporting its annual BCF performance to stakeholders. In Category 3, SHE Transmission provided evidence on how it has taken learning from a connection project and rolled it out more generally to benefit other projects, as well as how it is measuring and monitoring its connections processes and

performance to apply business practice adjustments or re-organisation required to address any issues identified.

For the final EDR submission later this year, SHE Transmission should look to follow up with examples of the impacts that its re-organisation and new approaches to whole systems are having. Some specific criteria that SHE Transmission should look to better evidence are: that its annual transmission planning processes exceed business as usual (BAU) activities ie the Networks Options Assessment process, for example SHE Transmission is proactive in seeking cross-vector information/interactions relevant to its transmission area; and how stakeholder engagement is influencing its business practices for low carbon connections.

### ***SP Transmission***

SP Transmission achieved a leadership score for the 2019/20 scheme year, as it did for the 2018/19 scheme year. Similar to SHE Transmission, this was the first year that SP Transmission achieved a leadership score in all seven areas of the EDR.

Compared to last year, SP Transmission scored much higher for elements of Category 2 (whole system planning). Much of this improvement is attributable to better evidence on its leading contribution to removing regulatory and commercial barriers to whole system solutions; senior management and board level involvement on whole system issues; and that it had been proactive in getting input from other parts of the energy system to inform its network planning.

SP Transmission also improved in Categories 5 (non-conventional solutions) and 6 (non-greenhouse gas environmental issues) relative to last year. The main areas of improvement in Category 5 were evidence of the decisions SP Transmission had taken on non-conventional solutions in the scheme year and the decision making criteria used; and more specific evidence of key individuals that are accountable for developing a strong innovation culture within the company, and the actions they had taken. In Category 6, SP Transmission provided evidence of its work to increase the environmental considerations of its supply chain strategy, which was missing the previous year.

In its final RIIO-T1 EDR submission later this year, we will be looking for SP Transmission to evidence its leadership in contributing to whole systems planning, for example, by leveraging off the partnerships it established as part of its RIIO-2 business planning processes, and/or its preparation for delivering its RIIO-2 whole system strategy. Some other specific criteria that SP Transmission should also seek to more strongly evidence are: board-level oversight/involvement in engagement with key stakeholders such as the ESO;

and citing specific contributions made by employees as evidence that job description objectives have been effectively met.

### ***National Grid Electricity Transmission***

NGET also obtained an overall leadership score for the 2019/20 scheme year, which is the second time they have achieved this level in the EDR during RIIO-T1 price control.<sup>4</sup> Similar to the other TOs, NGET also achieved leadership in all seven areas of the EDR.

NGET improved its performance in all categories, with the greatest improvements occurring in Categories 5 (non-conventional solutions), 3 (low carbon connections), 2 (whole system planning), and 1 (strategic understanding).

In Category 5, NGET provided evidence that it made several changes in the scheme year that met the EDR criteria in this area. This included the establishment of a cross-organisational working group to support to the consideration and development of non-conventional solutions across the business; demonstration of working-level and senior management commitment to engaging with stakeholders on non-conventional network development; and a process for determining key stakeholder needs and how this should inform its network development approach.

NGET's evidence on Category 3 (low carbon connections) was also stronger than last year. Some notable examples are the actions NGET took in the scheme year to improve its external and internal transmission connections processes in response to the changing composition of its customer base. This included the scoping and development of digital solutions to improve the connection application experience for customers, as well as to improve the efficient delivery of its internal optioneering process for connections solutions. Another aspect that NGET provided evidence on was its above BAU engagement with stakeholders on developing coordinated solutions needed to deliver net-zero.

NGET also improved its score for Category 2 (whole system planning) by providing satisfactory evidence across all aspects. This included senior management responsibility and actions in the scheme year for whole system planning; activities on the decarbonisation of heat, electrification of transport, and the coordination of offshore wind connections; and how NGET has used external users' information and scenarios to inform its network development in a whole system planning context.

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<sup>4</sup> NGET achieved an overall leadership score for the 2015/16 scheme year, the second year of RIIO-T1.

NGET increased its score for Category 1 (strategic understanding), in part, because it evidenced its analysis on the implications of the UK's low carbon policies as part of its RIIO-2 business planning process, and went on to demonstrate how it responded, following its senior management review of this analysis, when formulating its RIIO-2 strategy.

In its EDR submission for the final year of RIIO-T1, we encourage NGET to focus on evidencing the outcomes associated with its strategic understanding of the challenges and opportunities of the low carbon transition ie the impact of its projects/activities on the ground rather than the inputs to these. Other specific criteria we would also like to see some improvement in is demonstrating improved performance in relation to its GHG reduction target for RIIO-T1<sup>5</sup>; and senior management and board level advocacy for non-conventional network development.

## **Ofgem decision on financial rewards**

In the EDR 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, we have concluded that SHE Transmission, SP Transmission and NGET have demonstrated this in the 2019/20 scheme year.

In line with the EDR guidance in which a licensee with a score equal to or greater than 90% receives a third of the potential maximum payment, we have decided to award SHE Transmission, SP Transmission and NGET £2m each.

This decision sets the value of the EDROt term for 2019-20 under Special Condition 3F of the electricity transmission licence. The money awarded to SHE Transmission, SP Transmission and NGET under this incentive, will be reflected in each TO's allowed revenue.

The value of the reward allocated for the 2019-20 scheme year amounts to £6m from a maximum potential payment of £6m. Accordingly, there is no residual amount to roll-over to the reward pot for the final EDR scheme year.

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<sup>5</sup> There are likely to be several different impacts on the TOs' business carbon footprints in 2020/21 from the changes in working patterns caused by the Covid-19 pandemic lockdown restrictions.



## **Next steps**

We will complete the final EDR scheme assessment for the 2020/21 scheme year in the coming year. If you have any queries about this letter, please contact Anna Kulhavy at [Anna.Kulhavy@ofgem.gov.uk](mailto:Anna.Kulhavy@ofgem.gov.uk).

Yours faithfully,

Min Zhu

**Deputy Director, Systems and Networks, Transmission**