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for energy consumers

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Dear colleague,

Decision on the RIIO-T1 Environmental Discretionary Reward Scheme 2016-17

This letter sets out the decision of the Authority¹ on the Environmental Discretionary Reward (EDR) scheme for the 2016-17 scheme year of the RIIO-T1 price control period.

The EDR scheme is a reputational and financial incentive in the price controls of Scottish Hydro Electric Transmission Plc (SHE Transmission), SP Transmission Ltd (SP Transmission) and National Grid Electricity Transmission Plc (NGET) (the companies). The scheme takes account of NGET's dual transmission (TO) and system operator (SO) roles.

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 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 2016-17 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 £4m to SP Transmission. The remainder of this letter sets out the detail behind this decision. For further information on the assessment process please see the EDR guidance.²

Submissions and results

For the 2016/17 scheme year SHE Transmission, SP Transmission and NGET all applied to the scheme.

Following Ofgem's assessment of the submissions, the companies were invited to attend the expert panel session, which was held on 12 October 2017. The panel members are chosen for their expertise and experience in low carbon and environmental issues:

¹ The Gas and Electricity Markets Authority

²https://www.ofgem.gov.uk/system/files/docs/2016/06/environmental_discretionary_reward_scheme_guidance_revision_3.pdf

- Steven McMahon, Associate Partner of RIIIO Electricity (non-voting Ofgem Chairperson)
- 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 agreed with Ofgem’s assessment of the companies.

Environmental Discretionary Reward for the 2016-17 scheme year

Company	Annual Statement	Performance band	Financial Reward
SP Transmission	Satisfactory	Leadership	£4m
SHE Transmission	Satisfactory	Proactive	None
NGET	Satisfactory	Proactive	None

Executive level annual statement (ELAS) assessment

The assessment team and EDR expert panel considered that the ELAS of all three companies met the requirement and were satisfactory.

Balanced scorecard assessment

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

SP Transmission

SP Transmission achieved a leadership score in the following five categories: ‘connections’, ‘innovation’, ‘network development approach’, ‘direct environmental impact’, and ‘business greenhouse gases’. It obtained a proactive score in ‘strategic understanding’ and ‘whole system planning’.

SP Transmission provided multiple pieces of evidence, of their activities and initiatives across the different categories, that were well explained and targeted in their submission narrative. In several areas SP Transmission provided good evidence of actions it had taken in the scheme year to improve outcomes for customers and consumers that were over and above business as usual. For example, in the connections area it showed how it had taken learning from a project to amend its connection policies to better meet the needs of different types of low carbon generators.

To improve its score in the strategic understanding category, SP Transmission needs to show that there is buy-in and oversight at board level. In the whole system planning category, it is important that SP Transmission highlights the specific contribution it makes to SP Energy Networks group activities in this area.

The expert panel asked SP Transmission about the impact of receiving an EDR reward last year. SP Transmission noted the positive cultural and behavioural impacts, motivating people across the company, raising awareness of sustainability across the organisation and, helping to increase the profile of EDR related issues and their consideration as part of internal business decisions. It also made clear that the EDR scheme process is now an

integrated aspect of their strategic management, and is considered routinely through the organisation as part of what are becoming normal business practices.

SHE Transmission

SHE Transmission achieved a leadership score in 'innovation' and 'business greenhouse gas emissions'. It achieved a proactive score in 'network development approach', 'direct environmental impact' and 'whole system planning', and an engaged score in 'strategic understanding' and 'connections'.

SHE Transmission provided good evidence of a systematic approach to its innovation activity. Another example is that it showed it had achieved its annual target to reduce leakage in SF₆ gas, a powerful greenhouse gas.

For the most part, SHE Transmission targeted evidence to the specific EDR requirements (but less well in the 'strategic understanding' and 'connections' categories). To improve its score in future EDR submissions SHE Transmission should submit better quality evidence, particularly for aspects relating to activity undertaken, impact or contribution within the scheme year. SHE Transmission could also gain a higher score if it better demonstrated how stakeholder engagement has influenced its strategy or approach in areas such as network development.

The expert panel commended SHE Transmission on its improvement in the EDR scheme compared to the previous year. It noted that a similar level of improvement over the next year could mean SHE Transmission achieving a leadership score. The panel also advised SHE Transmission to include stronger evidence on how it is seeking to improve its processes and the impact for customers and consumers. The panel welcomed the fact that SHE Transmission were now treating the EDR as an important year-round focus for shaping company strategy and practices, rather than simply an annual regulatory requirement to gather evidence and report to Ofgem.

NGET

NGET provided evidence of leadership in three of the seven categories ('innovation', 'network development approach' and 'direct environmental impact'). It also achieved a proactive score for 'strategic understanding' and 'business greenhouse gas emissions', and an engaged score for 'whole system planning' and 'connections'.

In the 'innovation', 'network development approach' and 'direct environmental impact' categories, NGET provided good evidence to meet the requirements. This included evidence of a systematic approach to innovation, proactive stakeholder engagement to inform its network development strategy, and the adoption of policies to ensure its procurement activities help to drive sustainability within the supply chain.

To improve its score in future in other areas, NGET needs to ensure that the evidence it submits in its application comes from within the same scheme year and is referenced precisely in the narrative to the specific EDR requirements it relates to. In addition, NGET could provide stronger evidence to support claims about its impact/contribution and activity eg meeting minutes, management papers.

We note that NGET's score in category 2 (whole system planning) was not as high as it could have been because NGET said it was unaware of the requirement to provide supporting evidence for many of the questions, covering both of its roles as TO and SO.³

In the session with the expert panel, NGET questioned whether the EDR is too process driven, suggesting that the score did not adequately reflect the numerous relevant outputs

³ These areas are denoted with (SO & TO) in the [EDR scoring template](#) available on our website.

it has delivered. The panel advised that the EDR appropriately considered evidence on deliverables and outcomes, with the lower scoring reflecting that some of the evidence provided was undated or not relevant to the 2016/17 scheme year.

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 assessment team's scoring and discussion with the company representatives, the EDR panel concluded that SP Transmission had demonstrated this. Drawing on the panel's view, and in line with the scheme guidance in which a sole leadership company with a score between 80% and 90% receives up to two thirds of the amount available, we made a recommendation to the Authority to make a reward of £4m to SP Transmission. The Authority decided to make the recommended award.

This decision sets the value of the EDROt term for 2016-17 under Special Condition 3F. The money awarded to SP Transmission under this incentive, with appropriate interest adjustments, will adjust the amount of the Output Incentive Revenue Adjustment term, to reflect the company's performance in relation to the EDR. This adjustment will be reflected in the 2018-19 Allowed Transmission Owner Revenue, as derived under Special Condition 3A.

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 the Authority made a financial reward of £4m from a pot of £6m, this leaves an unallocated amount of £2m. As up to half of the total available annual funding can be rolled over to next year the maximum reward for the 2017-18 scheme year will be £6m again.

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 Anna Kulhavy at Anna.Kulhavy@ofgem.gov.uk.

Yours faithfully

Steven McMahon
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