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Dear Colleague,

Decision on the RIIO-T1 Environmental Discretionary Reward Scheme 2017-18 – Electricity Transmission Licensees

This letter sets out the decision of the Authority¹ on the Environmental Discretionary Reward (EDR) scheme for the 2017-18 scheme year of the RIIO-T1 price control period.

The EDR 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). Like previous years, for this scheme year, the scheme takes account of NGET's dual transmission (TO) and system operator (SO) roles. We discuss below the arrangements for the 2018-19 scheme year for NGET relating to the separation of the electricity system operator (ESO).

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 2017-18 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 SHE 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 scheme.² 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.

¹ The Gas and Electricity Markets Authority

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

The EDR application is in two parts. First, 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 element is an assessment of the evidence provided by the company against the requirements of the balanced scorecard. The categories of the scorecard 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%

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 results

The licensees all applied to the scheme for the 2017-18 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 5 October 2018. The panel members are chosen for their expertise and experience in low carbon and environmental issues:

- Clothilde Cantegreil, Head of RIIO Electricity Transmission Policy (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 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	81%: Leadership	£4m
SP Transmission	Satisfactory	69%: Proactive	None
NGET	Satisfactory	68%: Proactive	None

Executive level annual statement (ELAS) assessment

The assessment team and EDR expert panel 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 encouraged all the licensees to focus on improving their quality assurance (QA) processes and dissemination of EDR feedback across their organisations to improve future submissions. The panel also noted their concern that none of the licensees scored leadership in category one³ and encouraged development in this area for next year. To improve their score in this category, the panel emphasised that companies should use projects as examples of how their wider company strategy drove and influenced the outcomes of the project, rather than just as standalone evidence.

Scottish Hydro Electric Transmission

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

SHE Transmission provided positive evidence of an internal review of last year's EDR submission considering feedback and actions necessary to improve their score. The narrative throughout category responses was generally of good quality and demonstrated that the licensee has put in place a number of additional strategies targeted at sustainability; for example, establishing a Board sub-committee with responsibility for sustainability, and extensive ongoing stakeholder engagement. SHE Transmission has also embedded a whole system planning approach across its business.

For the most part, SHE Transmission targeted evidence to the specific EDR requirements (although less so in the 'strategic understanding' and 'direct environmental impact' categories). To improve its score in future EDR submissions, SHE Transmission should submit higher quality evidence, particularly for aspects relating to activities undertaken, and impact or contribution within the scheme year.

³ Strategic understanding of, and commitment to, low carbon objectives and the role of the applicant company in their facilitation

The expert panel commended SHE Transmission on its improvement in the EDR compared to the previous year, and acknowledged SHE Transmission had acted very well on last year's feedback. The panel encouraged SHE Transmission to focus on the 'strategic understanding' category over the next year, and suggested that SHE Transmission could improve performance by linking projects used in their evidence to their strategy.

SP Transmission

SP Transmission achieved a leadership score in four of the seven categories ('connections', 'network development approach', 'direct environmental impact', and 'business greenhouse gas emissions'). It obtained a proactive score in the 'strategic understanding', 'whole system planning', and 'innovation' categories.

SP Transmission provided good evidence that it has continued to build on last year's consultation on its connection policies to further meet the needs of different types of low carbon generators. In the 'network development approach' category SP Transmission also provided strong evidence of their engagement and activities on non-conventional alternatives to network development.

In a number of instances, SP Transmission did not provide sufficient supporting evidence to demonstrate their specific contribution in the stated action/practices. In all categories, including the 'innovation' category, it is important that SP Transmission highlights the specific contribution it makes to SP Energy Networks group activities in each area.

The expert panel asked SP Transmission how the EDR scheme has driven continual company performance. SP Transmission noted that the EDR has changed their focus and behaviour, and has helped drive their efforts on sustainability and the low carbon transition. An example given to support this was the implementation of policies and programmes by SP Transmission where sustainability is a key feature.

National Grid Electricity Transmission

NGET achieved leadership score in three of the seven categories ('connections', 'innovation', and 'business greenhouse gas emissions'). It obtained a proactive score in the 'strategic understanding', 'whole system planning', 'network development approach', and 'direct environmental impact' categories. NGET had a significant improvement in their score in this year's EDR scheme.

NGET provided good evidence to meet the requirements in the 'connections', 'innovation', and 'business greenhouse gas emissions' categories. For example, in the 'connections', and 'innovation' categories NGET demonstrated good collaboration and proactive stakeholder engagement to inform their processes and actions.

To improve its score in the 'strategic understanding' category, it is important that NGET shows how its wider strategy and priorities has been informed by its understanding of the low carbon transition, and how its strategic priorities then influence its projects and activities. NGET showed considerable improvements in the 'whole system planning' category. To further improve in this category, NGET needs to provide evidence of board level involvement and drive on whole system planning, above business as usual, to deliver better whole system outcomes. NGET also needs to ensure that evidence it submits relates directly to specific activities in the scheme year.

The expert panel commended NGET on its improvements this year, particularly in the 'whole system planning' and 'connections' categories where, following feedback from last year, NGET provided stronger supporting evidence covering both of its roles as TO and SO. The panel noted that following separation of the ESO, NGET will need to adapt its processes to engage with the ESO, and sharpen its focus on the TO, for next year's EDR submission. Finally, the panel recommended NGET consider ways to improve the transparency of TO level performance in its public communication.

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 EDR panel concluded that SHE Transmission had demonstrated this. Following its recommendation, and in line with the scheme guidance in which a licensee with a score between 80% and 90% receives up to two thirds of the potential maximum payment, we have decided to award £4m to SHE Transmission.

This decision sets the value of the EDRO_t term for 2017-18 under Special Condition 3F. The money awarded to SHE Transmission under this incentive, with appropriate interest adjustments, 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 reflected in the 2019-20 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 2017-18 scheme year amounts to £4m from a maximum potential payment of £6m, this leaves an unallocated amount of £2m. As up to half of the total available annual funding can be rolled over to the following year, the maximum available reward for the 2018-19 scheme year will be £6m again.

Changes to the scheme for next year

For the EDR scheme submission in 2019, covering the 2018-19 scheme year, we will only require NGET to submit an application covering their TO business. This is to acknowledge the separation of NGET's ESO functions to National Grid Electricity System Operator Limited (NGESO).

We note that legal separation does not enter into force until the 1 April 2019 (i.e. at the start of the 2019-20 scheme year). However, 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.

In addition to the practical issues around preparing the EDR submission across separate licensees, 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.

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 James Tyrrell at James.Tyrrell@ofgem.gov.uk.

Yours faithfully,

Min Zhu
Deputy Director, Systems and Networks, Electricity Transmission Sector