

Press Release

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SUSTAINABLE ENERGY NETWORKS: RIIO DEMANDS INNOVATION AND EFFICIENCY

New price review regime (RIIO) sets out:

- **Strong incentives and penalties to encourage smarter, more sustainable networks, delivering improved customer service**
- **£400 million of new funding for projects which deliver cost-effective environmental benefits to consumers between 2013 - 2021**
- **New RIIO price model should save consumers £1 billion over the next eight years**
- **Companies required to deliver outputs and standards informed by consumers**

Ofgem has today announced how the new performance-based RIIO framework will encourage the efficient investment and innovation required for Britain's gas and electricity transmission and gas distribution networks. The price controls for these networks will run for eight years from 2013-2021.

RIIO (Revenue=Incentives+Innovation+Outputs) is designed to incentivise companies to meet the unprecedented challenges they will face during the next decade: to find over £30 billion of investment needed to meet environmental targets and secure energy supplies, while delivering long-term value for money for consumers. This would double the rate of investment from the previous 20 years.

Ofgem believes that a "carrot and stick" approach of strong incentives and penalties stimulate greater efficiency from the companies. Successful companies that deliver will be rewarded. Any that do not will be penalised.

The package will include funding to encourage innovative investment solutions at low costs for consumers. To encourage greater innovation, Ofgem will set up a £400 million fund for the transmission and gas distribution companies. This is based on the successful Low Carbon Networks Fund already in place for electricity distribution networks.

Alistair Buchanan, Ofgem's Chief Executive, said: "Britain's energy networks have a huge role to play in delivering over £30 billion of the £200 billion of energy investment needed in the next ten years. This is why it is important that Ofgem sets companies a clear incentive framework to deliver the necessary investment and innovation as cost effectively as possible for consumers.

“It is now up to companies to rise to the challenge. They must set out by the end of July how they are going to ensure safe, reliable networks with high levels of customer service while delivering the investment necessary to meet the needs of a low carbon economy.”

Notes to Editors

1. These decisions are the first key milestones in implementing the new performance-based RIIO model and follow extensive consultation with stakeholders.

2. Full details will be published in the Strategy Decision Document at the end of March. The companies will then have to put together detailed business plans informed by their stakeholder engagement and submit these to Ofgem before the end of July. The regulator will only be able to agree a price control settlement with a company once it is satisfied that its business plan provides good value for money for consumers and contributes to a low carbon future.

3. Key features of Ofgem’s decisions include:

- **Sustainability embedded in business planning.** Network companies must outline the strategy they will use to ensure they play a full role in delivering a sustainable business sector.
- **Environment focussed output measures.** Ofgem’s proposals also include a suite of measures to promote timely connection of new sources of energy, reduce greenhouse gas emissions, reduce the visual impact of the networks, and reduce the companies’ own business carbon footprints. These will be worth around £700 million over the control period across the transmission and gas distribution sectors.
- **A new broad environmental measure.** There will be a reputational incentive on promoting low carbon energy flows. For the electricity transmission companies we also intend to introduce a financial reward to facilitate a greater contribution to the UK’s environmental objectives. We intend to consult further on the operation of this mechanism.
- **Financing new investment.** Ofgem remains committed to ensuring efficient companies can raise the debt and equity finance they need to invest in safe and secure future networks and that they are remunerated appropriately. **The strong financial package Ofgem is setting out includes:**
 - **Asset lives** – to ensure fairer sharing of the cost of assets between present and future consumers, new electricity transmission assets will be depreciated over 45 years. Existing electricity assets will continue to be depreciated over current lives (20 years). This policy will also apply to electricity distribution companies from 2015, the beginning of the of the next price control period. All post-2002 gas assets will continue to be depreciated over 45 years.
 - **Depreciation** – post-2002 gas distribution assets will be depreciated on a front-loaded basis, not just new and pre-2002 assets as was our position in December. There is no change in the depreciation profile for gas transmission.
 - **Cost of equity** – Ofgem is setting an indicative range of 6.0–7.2 per cent which we expect to inform the companies’ business plans.
 - **Cost of debt** – we are providing greater certainty by using an index for determining the allowed cost of debt. We are proposing to use the iBoxx non-financials 10+ maturity index, which is more representative of the companies’ debt costs than our previous proposal.

4. Next Steps

Following the publication of Ofgem's full strategy document at the end of March companies have until the end of July to consult with their stakeholder to develop their business plans. Ofgem will then assess these plans and decide whether any plan is of sufficient quality to allow the company to conclude its price control process earlier under a "fast track" process. Ofgem will publish its initial assessment of all the companies' business plans in October 2011.

5. Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Act 2004 as well as arising from directly effective European Community legislation.

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