

Price controls explained

Ofgem, as the regulator, sets price controls for the companies that operate Britain's gas and electricity networks. This factsheet explains why price controls are needed, how they work and what they mean for the domestic consumer.

Price controls are needed as these networks are natural monopolies and therefore there is no realistic way of introducing competition across the whole sector. Price controls are a method of setting the amount of money (allowed revenue) that can be earned by the network companies over the length of a price control. These companies recover their allowed revenues from their charges to suppliers who in turn pass these costs through to customers. The revenues have to be set at a level which covers the companies' costs and allows them to earn a reasonable return subject to them delivering value for consumers, behaving efficiently and achieving their targets as set by Ofgem.

There are three separate price controls that apply to the different areas of energy transportation:

Transmission (RIIO-T1) – This price control relates to the high voltage transmission of electricity and high pressure transmission of gas for the period 2013 to 2021. Gas transmission accounts for around 2% and electricity transmission around 4% of a consumer's bill.

Gas Distribution (RIIO-GD1) – This price control relates to the period 2013 to 2021 for the companies that transport gas at a lower pressure to homes and companies for domestic and commercial use. Gas distribution accounts for around 16% of a consumer's gas bill.

Electricity Distribution (RIIO-ED1) – This price control relates to the companies that transport electricity at a lower voltage to homes and companies for domestic and commercial use for the period 2015 to 2023. Electricity distribution accounts for around 16% of a consumer's electricity bill.

RIIO's Role

RIIO is Ofgem's new framework for setting price controls. Over the next decade the network companies face an unprecedented challenge of securing significant investment to maintain a reliable and secure network.

As the regulator, Ofgem must ensure that this investment is delivered at a fair price for consumers. To help achieve this, Ofgem developed RIIO (Revenue=Incentives+ Innovation+Outputs) – a new performance based model for setting the network companies' price controls, which will last eight years. RIIO is designed to encourage network companies to:

- Put stakeholders at the heart of their decision-making process
- Invest efficiently to ensure continued safe and reliable services
- Innovate to reduce network costs for current and future consumers
- Play a full role in delivering a low carbon economy and wider environmental objectives

The RIIO process

Under RIIO, Ofgem asks companies to submit well-justified business plans detailing how they intend to meet the RIIO framework objectives. The process starts with the publication of a strategy document in which we set out the framework against which the companies will develop their plans. RIIO places a strong emphasis on stakeholder engagement and companies must get stakeholders' input and demonstrate how this has been used to develop their plans.

Ofgem reviews these plans to determine what levels of proportionate treatment – that is the levels of scrutiny - we will apply. Where a company's business plan is of particularly high quality we will determine whether the company's new price control settlements can be agreed early – i.e. fast-tracked. Those companies that are not fast-tracked are asked to resubmit their business plans to Ofgem.

RIIO-GD1

There are four gas distribution companies operating in Britain. These are National Grid Gas (NGG), Scotia Gas Network (SGN), Northern Gas Networks (NGN) and Wales & West Utilities (WWU). Ofgem's decision on their price control package was published in December 2012.

The plans from these companies will deliver an estimated £8.7 billion to ensure that Britain's low pressure gas networks, which deliver gas to homes and businesses, remain safe and reliable.

The money will fund the continued maintenance across Britain of the gas distribution network, in particular the gas mains replacement programme. In addition, our proposals would enable the gas distribution companies to connect up to 80,000 fuel poor households to the main gas network, giving them access to gas, which could be a cheaper alternative.

RIIO-T1

Scotland

As part of the transmission price control (RIIO-T1), Scottish Power Transmission and Scottish Hydro Electricity Transmission (SSE) were fast-tracked and their price controls were finalised in April 2012. The price controls earmark around £7 billion of investment for Scotland's high voltage network, delivering much needed investment to replace ageing infrastructure and enabling greater connections to renewable generators.

England & Wales

National Grid owns the high voltage electricity network in England & Wales and the high pressure gas network across Britain. Ofgem's decision on their price control package was published in December 2012. These proposals earmark around £15.5 billion of investment to upgrade and renew the networks over the course of the price control.

RIIO-T1 Plans at a Glance

| Scottish Power & Scottish Hydro Electricity Transmission | National Grid |
|---|--|
| Around £7 billion investment | Around £15.5 billion investment |
| Key projects include potential new sub-sea links from Scotland's islands to the mainland | Major projects include a new sub-sea electricity cable linking England/Wales and Scotland. |
| Over 1,500 jobs are estimated to be created as a result of infrastructure upgrades | Around 7,000 jobs could be created, mainly in the construction supply chain |
| £470 million available to help fund undergrounding & visual amenity measures for new infrastructure | |
| Introduced funding for improving visual amenity of existing infrastructure in National Parks and Areas of Natural Beauty (AONB) | |
| Estimated average annual cost on consumers' bill is £12 (this is not cumulative) ¹ | |

¹ For a further breakdown see note 3 in the Press Release <http://www.ofgem.gov.uk/Media/PressRel/Documents1/20121217-Press-Release-RIIO.pdf>

RIIO-ED1

Electricity distribution networks carry electricity from the high voltage transmission network to homes and businesses. In Britain there are 14 licensed electricity distribution network operators (DNOs), each responsible for a specific area. These 14 DNOs are owned by six different groups as set out in the map.

The RIIO-ED1 control will operate from 2015 – 2023, during which time there is likely to be an increase in the take up of low carbon technologies such as heat pumps, electric vehicles, solar panels and wind generation. These will play an important role in meeting the UK's greenhouse gas emissions targets.

In March 2012, Ofgem published the Strategy Decision which will form the basis for the DNOs to develop their business plans.

What RIIO-ED1 means for consumers

Improved reliability – Strong incentives to ensure reliable supply

- Our plans give better rights to consumers by reducing from 18 to 12 hours the time at which customers are entitled to payments if they experience prolonged power cuts. The level of these payments will rise in line with inflation.
- DNOs will have to make these payments automatically to vulnerable customers.
- These payments apply to all customers equally, including those living in the Scottish Highlands and Islands, who were previously exempted.
- The 'worst served customer' funding will remain for DNOs to make network improvements in more remote locations. This is a 'use it or lose it' fund for the DNOs to ensure that companies are only funded for what they provide for customers.

Improved Customer Satisfaction – We are building on the Broad Measure of Customer Service that includes an independently conducted assessment of stakeholder engagement and also a customer survey. In RIIO-ED1 we are increasing the incentive and size of penalty if targets are missed.

Quicker Connections – We are introducing a package of connections incentives aimed at encouraging the DNOs to provide a better service for connecting customers, including those connecting low carbon technologies and distributed generation, such as solar panels. These include a time to connect incentive for smaller customers, customer satisfaction surveys and a connection engagement incentive for larger customers.

Focus on Social Obligations – We expect to see clear evidence in DNO's business plans of how they will work in partnership with other industry members (for example suppliers, other DNOs, gas distribution companies and wider

stakeholders) to share information of customers who are on Priority Service Registers and how they intend to target this support. They will be assessed on their delivery of these activities in each of these areas, with their performance informing the allocation of reward using a 'balanced scorecard' approach.



The activities and behaviours they will need to undertake to fulfil this social obligation role in RIIO-ED1 include:

- Improving the quality of information they have about vulnerable consumers and how it is used so that these consumers get the support and services they require.
- Engaging with local authorities, devolved administrations, health providers, suppliers, other energy distributors (both gas and electricity), other utility providers and community groups. This engagement should consider how best to use the information they collectively hold on consumers in vulnerable situations.
- Providing assistance for those customers that are on a DNO's Priority Service Register in need of additional assistance.
- Utilising relationships and building partnerships with other parties to identify and deliver solutions (both energy and non-energy) for affordable energy, including for consumers off the gas grid.
- Embedding their strategy for addressing consumer vulnerability in their systems, processes and how they manage customer interactions.

Environmental outputs:

RIIO-ED1 contains a number of outputs focused on the environment, including:

- A scheme for undergrounding existing lines in areas of outstanding natural beauty, national parks and national scenic areas. The scheme has a total funding pot of £103.6 million over the 8 year period.
- A requirement for DNOs to report annually on their business carbon footprint, including sulphur hexafluoride. Ofgem will publish a league table of each DNOs performance in the Electricity Distribution Annual Report.

Innovation:

There will be an innovation stimulus in RIIO-ED1, which comprise of three components:

- The Network Innovation Competition (NIC) - this replaces the Low Carbon Network (LCN) Fund and will apply to electricity transmission and distribution companies. For the first two years of ED1, the NIC fund for electricity will be £90m per year (adding £60m to the £30m already committed in RIIO-T1).
- The Network Innovation Allowance (NIA) – aims to fund small-scale innovation projects. Value defaults to 0.5% of allowed revenues unless companies excel in demonstrating a well thought through innovation plan up to a maximum size 1% of allowed revenue.
- The Innovation Roll-out Mechanism (IRM) – a mechanism to enable companies to apply for additional funding to roll-out a proven innovation, which meets defined criteria.

RIIO-ED1 timetable

| Phase | Year | Month | Milestone |
|--|------|-----------|--|
| Strategy Development | 2013 | March | Strategy Decision published |
| Initial Business Plan Assessment and Fast-Track Decision | | July | DNOs submit & publish business plans Invitation for comments (4 weeks) |
| | | September | DNO bilateral meetings with the Consumer Challenge Group DNO bilateral meetings with the Committee of Authority |
| | | October | Initial assessment and fast-track Draft Determination published (8 weeks consultation) |
| Draft and Final Determinations and Launch | 2014 | February | Fast-track Final Determination published |
| | 2014 | March | Non-fast-track DNOs resubmit & publish business plans Invitation for comments (4 weeks) |
| | | July | Non-fast-track Draft Determination published (8 weeks consultation) |
| | | November | Non-fast-track Final Determination published |
| | 2015 | December | Statutory Consultation (28 days) on licence modifications |
| | | April | Wednesday 1st - new price control (ED1) commences |

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