

RIIO - (Revenue = Incentives + Innovation + Outputs)

# RIIO UPDATE

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## RIIO Re-cap

RIIO is Ofgem's new method of setting the amount of revenue that can be earned by the companies which transport gas and electricity throughout Great Britain. These network companies can earn their allowed revenues from the charges they levy on users of their networks. The revenues have to be set at a level which covers the companies' costs and earn a reasonable return subject to them behaving efficiently and achieving their expected outputs.

Price controls are required because the network businesses are natural monopolies and therefore there is no realistic means of introducing competition across the whole sector. 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. Gas transmission accounts for around 2% and electricity transmission around 5% of a consumer's bill.

**Electricity Distribution (RIIO-ED1)** – These companies transport electricity at a lower voltage to homes and companies for domestic and commercial use. Electricity distribution accounts for around 18% of a consumer's bill.

**Gas Distribution (RIIO-GD1)** – These companies transport gas at a lower pressure to homes and companies for domestic and commercial use. Gas distribution accounts for around 19% of a consumer's bill.

Over the next decade these energy companies face an unprecedented challenge of securing over £30 billion for investment to maintain security of supply. This investment will help to replace ageing infrastructure and build new infrastructure to support the increase of renewable forms of energy, such as wind farms and the power demands of an increasingly low carbon economy.

As the sector's economic regulator, Ofgem must ensure that this investment is delivered to time and 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 run over an eight-year period. RIIO is designed to:

- » encourage network companies to play a full role in delivering a low carbon economy and wider environmental objectives
- » invest efficiently to ensure continued safe and reliable services
- » innovate to reduce network costs for current and future consumers.

## Features in this issue include...

**Introducing RIIO-ED1  
Transmission updates**

**Senior Partner, Hannah Nixon gives her view on RIIO so far and in the future**

## The RIIO Process

For each of the RIIO price controls (RIIO-T1, RIIO-GD1 & RIIO-ED1) 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 - or *fast-tracked*.

# Towards a world of electric vehicles and solar panels: Introducing RIIO-ED1

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.



Ofgem launched RIIO-ED1 in February 2012 with a consultation seeking views on what we see as the key issues for the review. We will publish a consultation on our strategy to guide each DNO's development of its business plans in September. This will be followed by our strategy decision in February 2013.

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 the RIIO-ED1 review we need to ensure that the DNOs can connect these technologies without delays or high costs. The problem is that no one is sure how many and where these technologies will appear.

Initially these new technologies are likely to appear in clusters. For example, where certain areas of a city start buying electric vehicles or where solar panel installers sell street by street. In those areas the network may need additional capacity.

One challenge for us in RIIO-ED1 is balancing the need for more network capacity to enable faster connections against ensuring customers don't pay for redundant assets if the new technologies are not connected as expected. The good news is that we believe smart grid technologies and demand side response should provide a more cost effective way of creating the flexible networks required. Ofgem has already kick-started innovation in this area via the Low Carbon Network Fund, which since 2010 has been awarding funding to DNOs for innovation projects that aim to tackle some of these issues.



## RIIO-ED1: Engaging Stakeholders

The DNOs are expected to make stakeholder engagement a key part of their process in producing well-justified business plans for RIIO-ED1. These business plans will demonstrate exactly how the companies have incorporated stakeholder feedback and set out their plans for 2015-2023 and also how they plan to involve stakeholders in the operation of their business over the period.

Ofgem will also be talking to stakeholders and building on the learnings from RIIO-T1 and GD1 to maximise the input from the different stakeholders. In addition to consultations, as part of RIIO-ED1 stakeholder engagement:

- Ofgem will conduct one-to-one meetings with key stakeholders
- The high level stakeholder group, Price Control Review Forum (PCRF), will provide input at key stages in the RIIO process
- The Consumer Challenge Group (CCG), which is a small group of consumer experts, will ensure that the views of consumers are considered fully in the review.

## RIIO-ED1 Timetable

Phase	Year	Month	Milestone
Strategy Development	2012	February	Open Letter Consultation Published (8 weeks consult)
		September	Strategy Consultation Published (8 weeks consult)
Initial Business Plan Assessment	2013	February	Strategy Decision Published
		June	Business Plans Submitted
		September	Initial Assessment Published (4 week consult)
	2014	November	Fast Track Consultation Published (8 weeks consult)
		March	Fast Track Decision Published
Initial Proposals	2014	June	Initial Proposals Published
Final Proposals	2014	November	Final Proposals Published
		December	Statutory Consultation on Licence Mods
Launch	2015	April	Monday 1st - New Price Controls Commence

**Hannah Nixon** is Ofgem's Senior Partner for Distribution and has been part of the RIIO process since the beginning, having previously held the same position in Transmission. Here she writes about her view on RIIO so far and its future.

We launched RIIO in 2011 to ensure network companies play a full role in delivering a safe, reliable and sustainable energy sector at value for money. In many ways RIIO is a ground-breaking approach to setting price controls; challenging companies to think afresh about their long-term plans and how to bring consumers right to the centre of the decision making process. I am pleased to say that the companies are responding positively to the RIIO challenge. They are increasingly engaging effectively with their consumers and industry more widely and their plans are beginning to reflect this.

One of the bigger challenges that RIIO set out to address was the need to secure, at the lowest cost to consumers, over £30bn of infrastructure investment. The fast-tracked transmission plans of ScottishPower and Scottish and Southern Electric (SSE) have already established over £7bn of this funding with National Grid giving good indications of being able to provide further upgrades.

We are approaching the final stages of the transmission (RIIO-T1) and gas distribution (RIIO-GD1) price control setting processes, with the controls taking effect in April 2013. It is then we will start to see the delivery of the plans. Throughout the price control period Ofgem will monitor companies' delivery of outputs and their performance against the strict incentives Ofgem has set. This will be the true measure of RIIO's success.

Ofgem has already started the third price control stream with the launch of RIIO-ED1 earlier this year. The electricity distribution networks again face big challenges in the next decade to adapt to the changing electricity consumption of Britain. Ofgem and the industry are preparing for these changes and through RIIO we have the right framework to help address some of these issues. I am happy to say that the future of RIIO looks bright.

# On the Fast-Track

As part of the transmission price control (RIIO-T1), [ScottishPower](#) and [SSE](#) were *fast-tracked* and their price controls were finalised in April 2012. The price controls earmark over £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.

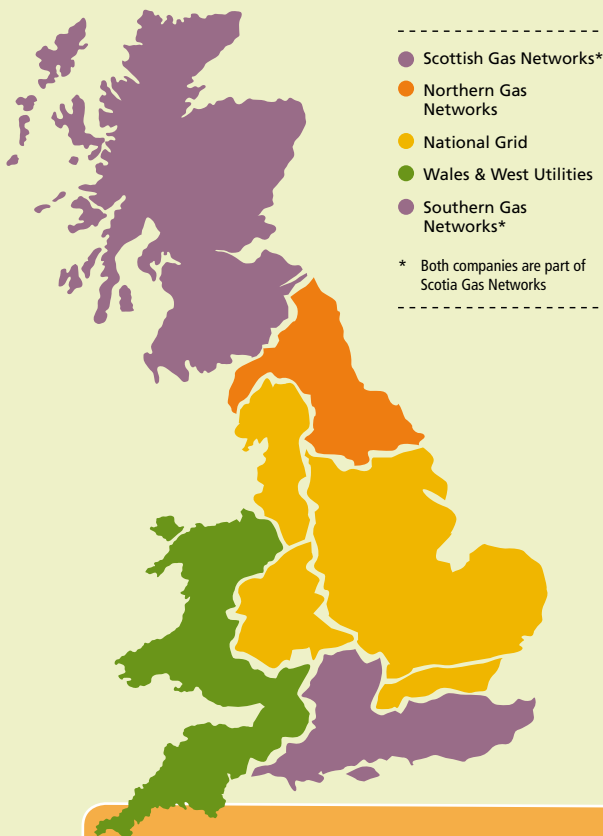
The plans are the first to be settled under the RIIO framework and Scottish Power and SSE can now benefit from the swiftness of the process and concentrate on delivering efficient network improvements for consumers.

Fast-track plans at a glance:

- £7.6 billion investment earmarked for Scotland's high voltage network
- Key projects include potential new sub-sea links from Scotland's islands to the mainland
- Over 1,500 jobs are estimated to be created as a result of infrastructure upgrades

## National Grid's Transmission Business Plans

**National Grid operates the high voltage electricity network and gas transmission system for the whole of England and Wales. The company resubmitted its RIIO-T1 business plans in March 2012 and Ofgem will consult on Initial Proposals in July 2012, followed by Final Proposals in December.**



## 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).

In June 2011 we revised the timetable for the first submission of GDN business plans. The revision was to enable the GDNs adequate time to reflect in their plans important changes by the HSE to the iron mains replacement programme. The HSE changes related to the way in which companies prioritised gas mains for replacement and the timeframe to complete these replacements.

Given the need to fully understand the impact of the HSE changes for their business plans, fast-tracking was recognised as a highly challenging prospect for the GDNs. In February, all GDNs submitted business plans and although there were many areas that were well developed, following review by Ofgem none were deemed suitable for fast-tracking.

The GDNs have now resubmitted revised business plans which are under consideration by Ofgem and Initial Proposals will be consulted on in July, followed by Final Proposals in December, in line with the timetable for the non fast-tracked transmission companies.

### Your feedback

We hope that stakeholders have found the second RIIO Update useful. If you would like to send any feedback to help us make the next RIIO Update even better, please email:

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