

# Press Release

26 July 2010

## OFGEM REENGINEERS NETWORK PRICE CONTROLS TO MEET £32 BILLION LOW CARBON INVESTMENT CHALLENGE

- **New price controls to drive smarter energy networks for a low carbon future**
- **Eight-year price controls to give long-term certainty to investors and keep investment costs for consumers as low as possible**
- **Companies that fail to deliver for customers will be penalised, but efficient companies can earn higher returns and fast-track price controls**
- **Low Carbon Networks fund to be expanded substantially to stimulate smart grids**

Network regulation is being reengineered by independent energy regulator Ofgem to drive smart, sustainable networks which will help Britain meet the challenge of moving to a low carbon economy at as low a price as possible for consumers. The step change in the size of the investment needed - **£32 billion\*** in the next 10 years - means that networks need to be smarter to better support the Government's policy goal of cutting emissions and securing energy supplies.

Britain's energy networks need to undergo a revolution if they are to meet the challenges of a low carbon economy. The way energy networks are designed and run will have to change dramatically over the next ten years to meet the challenge of connecting more local and remote renewable generation. Networks will have to be smarter to balance more intermittent renewable generation sources while at the same time managing increased demand for electricity through the electrification of transport and heat.

Ofgem is playing its part, within its regulatory remit, by reforming network regulation so companies have the right incentives to make the significant investment and innovation needed to make low carbon economy possible and deliver better services for network customers.

Ofgem's Chief Executive Alistair Buchanan said: "If Britain's energy networks are going to meet the challenge of delivering a low carbon economy then we need them to have innovation in their DNA. To bring about this change Ofgem is seeking to make regulation "smarter" by placing more emphasis on financial incentives to deliver efficient innovation and investment over a longer timescale.

"RIIO regulation will protect consumers by rewarding those companies that innovate and invest efficiently, but will punish those companies which perform badly for consumers with lower returns on their investment."

Ofgem's new proposal is to deliver a sustainable network regulation by using a new price control model - RIIO (Revenue=Incentives+Innovation+Outputs). The RIIO model builds on the success of the previous RPI-X regime, but better meets the investment and innovation challenge by placing

much more emphasis on incentives to drive the innovation needed to deliver the required outputs in terms of improved customer service and smarter grids.

While the need to invest is likely to increase bills,\* taking a longer-term approach to price controls with greater emphasis on incentives to encourage more efficient investment has the potential to reduce the investment bill for consumers.

Another key part of the package is a fairer and transparent approach to financeability, which will provide more clarity and predictability for companies and investors. This again will help keep the costs of the investment as low as possible for consumers. Ofgem's proposals will be subject to transitional arrangements which will be agreed for the individual price controls.

Key features of the RIIO model include:

- Much greater say for network customers in setting out what network companies need to deliver, i.e. renewable developers might want faster connections
- Fast track price controls will be introduced for companies who innovate, deliver good service and produce well-evidenced plans setting out how they will invest efficiently for the future. They will be rewarded with higher returns
- Poorly performing companies will face much more intrusive regulation and will face lower returns
- Lengthening price controls from five to eight years will provide more stability
- Stronger incentive regime to encourage more efficient investment and innovation
- Adding the option of giving new network companies a greater role in delivering certain large-scale projects where this does not delay delivery. This could open up new sources of finance and encourage innovation, and
- Expansion of the current low carbon networks fund to encourage greater innovation across gas and electricity networks.

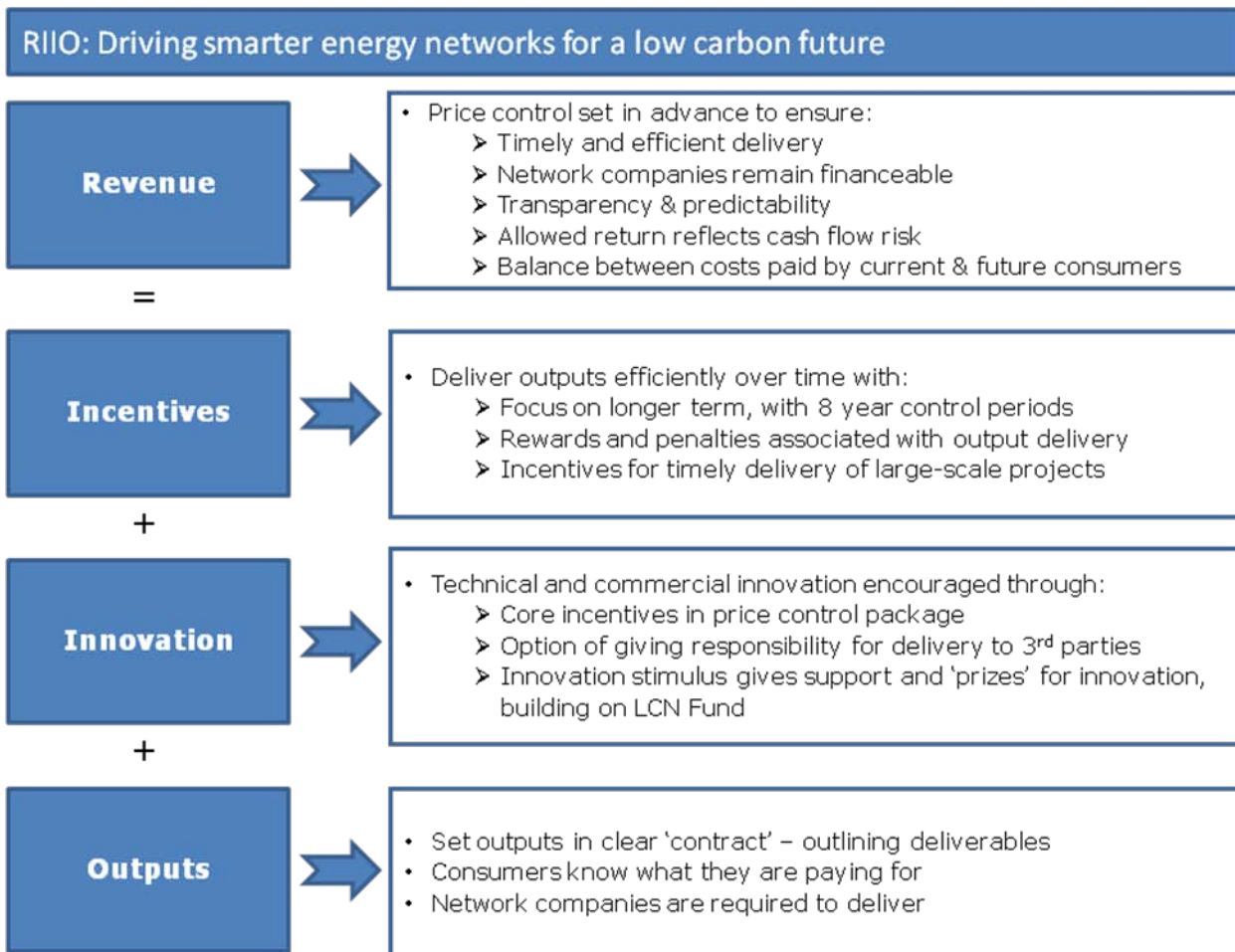
*\*This **£32 billion** is part of the estimated **£200 billion** that Ofgem estimates needs to be invested in the next 10 years to secure sustainable energy supplies at an affordable price for consumers. Ofgem's Project Discovery estimated that the cost of delivering all of the **£200 billion** investment could see energy bills rise by between 14% and 25% by 2020.*

**Ends**

## Notes to Editors

### 1. How will the new price control work?

Ofgem will be delivering sustainable network regulation using the RIIO model which stands for Revenue=Incentives+Innovation+Outputs. The table below summarises the main principles which Ofgem is consulting on.



### 2. Ofgem's 12 recommendations for consultation

#### 1. Objective:

To encourage network companies to:

- lay a full role in the delivery of a sustainable energy sector; and
- deliver long term value for money for consumers.

#### 2. Existing industry structure retained.

3. Greater say for network companies' customers in helping to shape their investment plans and objectives.
4. Clear guidelines on appeals on Ofgem's decisions.

5. Price controls to focus companies on delivering outputs, like greater reliability for consumers and quicker connections for renewable generators.
6. Key elements of RPI price control maintained, including setting control in advance for the next eight years, retaining a return on regulatory asset value, and keeping inflation indexation
7. Price controls to be set for eight years.
8. Efficient, well managed companies will be able to benefit from fast track price controls – more intrusive regulatory scrutiny for poorly performing companies.
9. Option to market test companies proposals for large projects to ensure value for money; possibility that new companies may help to deliver new projects where this could drive innovation, provide investment, value for money and timely delivery.
10. Incentive will reward companies who deliver investment efficiently and penalise poor performers.
11. Clear principles for efficient delivery can be financed by network firms.
12. Low Carbon Network fund to be expanded to stimulate smart grid and also more sustainable gas networks.

### **3. When will Ofgem's proposals be introduced?**

Ofgem's proposals, which have been developed through an extensive two year process of consultation with stakeholders, will be subjected to a further round of consultation with final proposals being published in September. The proposals will then be implemented gradually over the next two price controls for gas distribution and gas and electricity transmission. These are not due to start until 2013 and all proposals relating to these controls will be subjected to the usual open and transparent price control process. Electricity distribution price controls are not up for renewal until 2015.

4. 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.

### **For further press information contact:**

**Mark Wiltsher            020 7901 7006/07879 602 838**

**Chris Lock                020 7901 7225 / 07766 511470**

**Alison Wright            020 7901 7217 / 07771 980297**