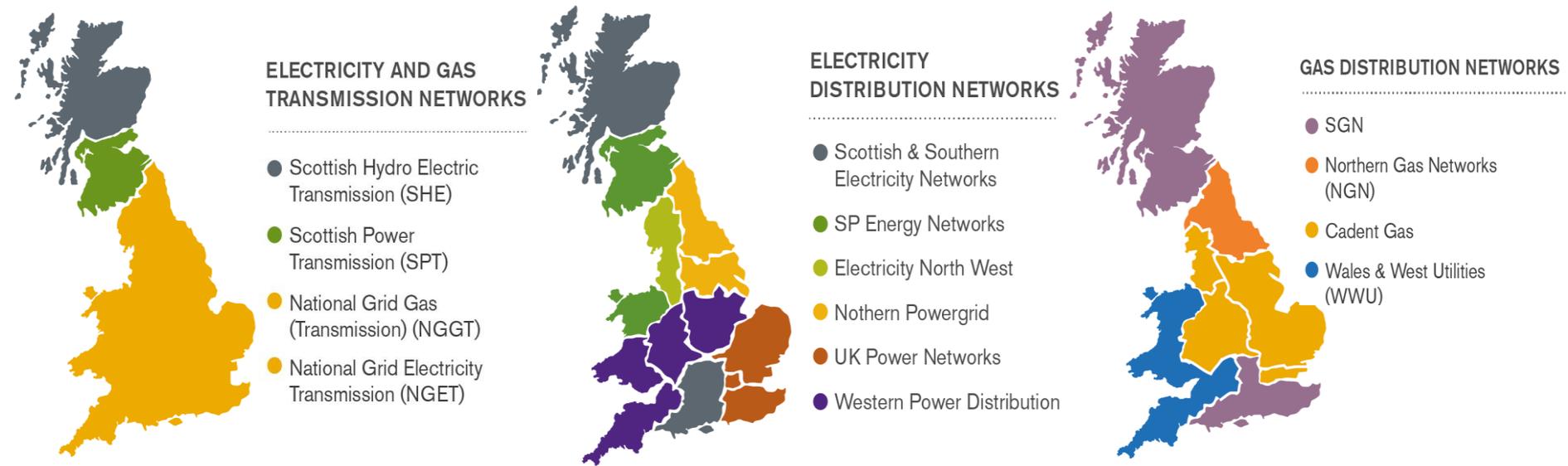


RIIO-2 Network Price Controls – Responding to the Net Zero Challenge



**Steve McMahon, Deputy Director
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09/06/2020

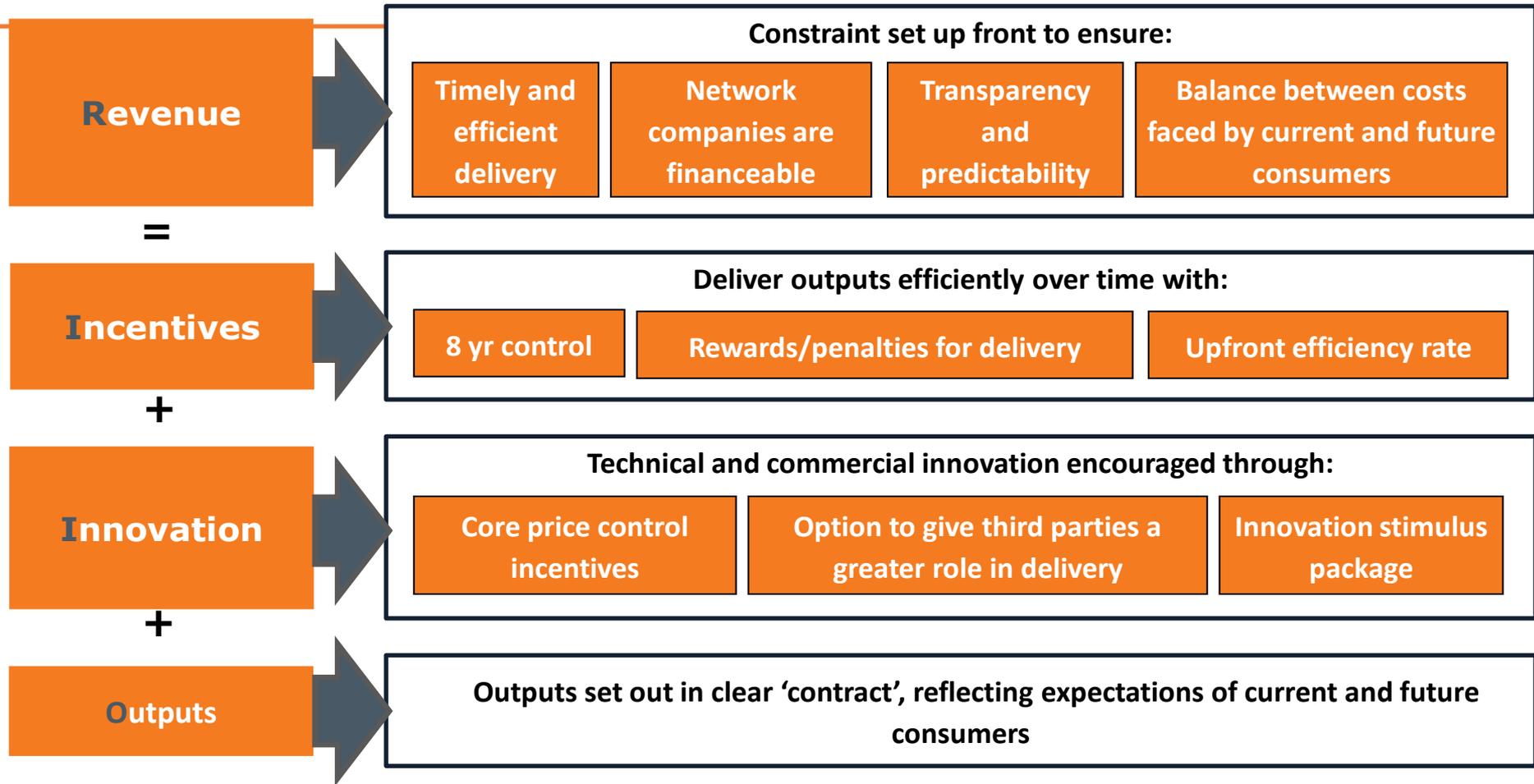
Energy network price controls form a quarter of the average dual fuel bill



Network Companies are natural monopolies

- Price controls are a very important part of our regulatory arrangements.
- We set a limit on the amount of revenue that companies can collect for a future period that reflects their efficient costs
- Network revenues amount to around £12.5bn per year. This amounts to around £250 per year, or a quarter of average household bills

Price controls have evolved since privatization, with the RIIO model introduced in 2013



Under RIIO:

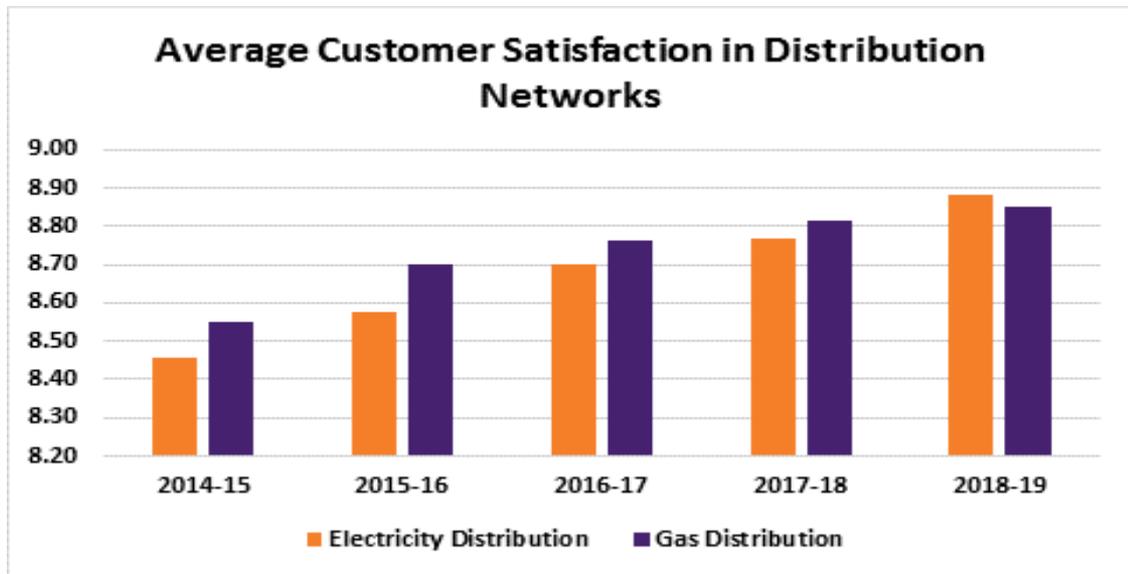
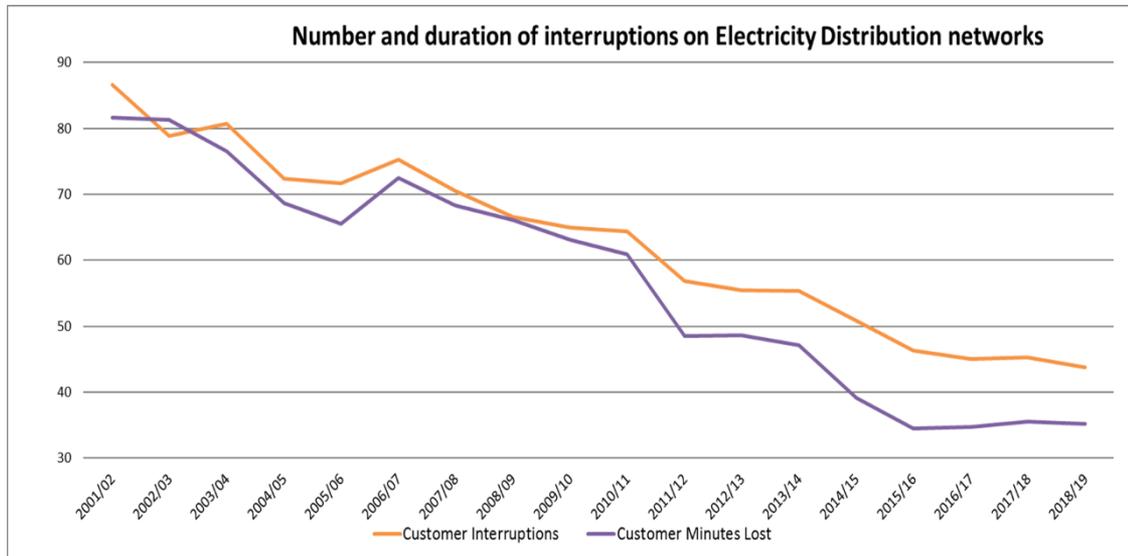
- companies accountable for delivering a high quality of service (through the use of “output” targets);
- financial incentives and a longer price control settlement of eight years to encourage innovation; and
- bias towards capital spending addressed through “totex” allowances, which fixes the proportion of total expenditure – regardless of whether it is capital or operating costs – that is added to the regulated asset base.

In RIIO-1, companies have delivered their output targets with high levels of reliability and customer satisfaction

RIIO has driven improvements in service levels and innovation

- Record levels of customer satisfaction, with companies performing well on output targets
- Power cuts on local grids are sharply lower (see graph at side). Electricity and gas networks are currently 99.99% reliable.
- Innovation spending is at its highest and could deliver £8bn of benefits for consumers.
- 25% of all electricity generation are now connected to lower voltage networks.

But company returns have also been at the higher end of expectations, which is why our tough new price control proposals will cut returns to save money



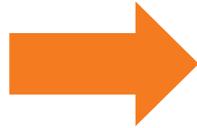
**Driving
value for
existing
consumers
in RIIO-2**



Our proposals include:

- **Cutting the allowed return on equity** to better align with current market conditions, and the risks facing networks, saving billions for 'green' upgrades
- Targeting **outputs and incentives** on the things that really matter to consumers
- Tough **scrutiny of spending plans** through Enhanced Engagement process
- Retaining **strong incentives to be cost-efficient**, but reducing the overall strength from RIIO-1 so consumers see a greater share of the gains from underspends
- Introducing **additional protections** to avoid the risk of excessive returns

**Protecting
future and
vulnerable
consumers**



Our proposals include:

- Retaining a **strong innovation stimulus**, for both big transformational R&D projects, as well as smaller scale process or technological innovations
- Setting outputs that ensures the networks can play a **full role in the decarbonisation** of power, heat and transport
- Introducing **new whole system mechanisms** to co-ordinate expenditure between transmission and distribution networks
- Introducing measures to **protect asset health, improve cyber resilience**, and ensure **high quality, well trained workforce**
- Targeted **package of support for vulnerable consumers** distribution sectors

- There is currently no single pathway to Net Zero, and we don't know how much it will cost to hit the target.
- In the meantime, we have made it clear that decarbonisation at lowest cost is one of our core corporate priorities as an independent economic regulator.
- As a regulator, we intend to regulate the energy networks so they can:
 - support ten million electric vehicles on our roads by 2030;
 - proactively support the coordinated expansion of the offshore transmission grid by 2030;
 - expand the range of possibilities for decarbonising heat, such as hydrogen, through greater use of innovation.
- **Through RIIO-2 our broad strategy is to encourage the networks to be as efficient as they can possibly be on running costs and the cost of capital, so we make support the new investment required while keeping bills affordable for consumers**

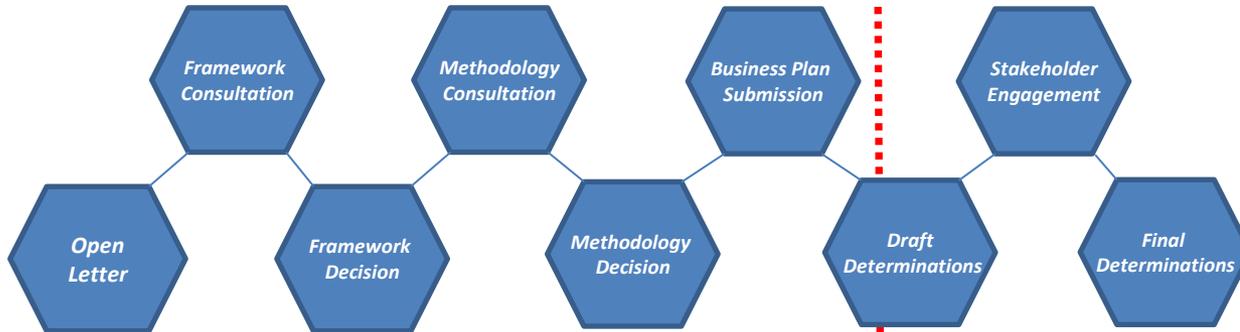
A need for greater coordination and flexibility in our approach

- There are two ways in which RIIO-2 will differ from its predecessor controls because of the net zero imperative.
- Firstly, our decisions on price controls need to be closely co-ordinated with those of policymakers in Government, and supportive of the UK's long-term infrastructure strategy and plans.
- Secondly, we intend to write a suite of net zero investment and innovation mechanisms which gives us the flexibility to dial allowances for investment or innovation up or down as policy for net zero continues to evolve, for any of the networks at any time.
- **In both these dimensions therefore, RIIO-2 will be materially different to our previous price controls.**

Developing our sector methodology for the electricity distribution networks from 2023

- The next electricity distribution price control (RIIO-ED2) starts two years later in April 2023 and raises some key questions:
 - How should investment in the local grids respond to more renewable energy being produced locally?
 - How should it respond to a rapid take-up of electric vehicles, and the need for a national network of charging points?
 - How far should it anticipate potential increases in electricity flows caused by the decarbonisation of heat, including the possibility that different parts of the country may opt for different solutions?
- We are approaching RIIO-ED2 very much with the attitude that meeting net zero at lowest cost may require a different approach compared to the other network sectors, particularly in areas such as anticipatory investment.
- **We will work hard with stakeholders through the second half of this year to construct an effective methodological framework that will allow good decisions to be taken for the key questions above.**

ET-2/GT-2/GD-2/ESO track



Price Controls
Start April 2021

2017

2018

2019

2020

2021

2022

2023

Electricity Distribution (ED-2) track



Price Control
Starts April 2023

WE ARE HERE