

Office of Gas and Electricity Markets

“OFGEM”

Revenue = Incentives + Innovation + Outputs

“RIIO”

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Background- Electricity Distribution in UK

- There are 14 Distribution Network Operators (“DNOs”) in the UK, owned and operated by 6 private companies, with each having 2.4 to 7.9 million customers.
- All end use customers buy from a retailer, Distributors do not own the meter.
- Competition has been phased in since 1990 with full competition since 1999.
- Average Residential customer in UK uses 3,300 kWh/year at a cost of 20.3 cents/kWh. Bills forecasted to increase 50% in next four years.
- DNOs have been regulated by Ofgem since 1990, currently on 5th Distribution Price Control (“DPCR5”) which set allowed revenues for 5 year period, April 1, 2010 to March 31, 2015.
- No intervenors or hearings as we have.



RPI-X

- RPI is the retail price index (includes changes in housing costs and mortgage interest repayments and X is an efficiency factor).
- X is based on comparisons to other utilities and a total factor productivity index.
- Distribution Price Control R5 also includes:
 - 3% swing on revenues depending on service quality
 - Information Quality Incentive (“IQI”) gives additional income for actuals close to budget and by providing a higher incentive rate for companies with lower forecasts
 - Includes incentives for innovation
 - Low Carbon Network Fund provided support for new technologies, operating and commercial arrangements need to move to low carbon economy.



RPI-X

- Also includes:
 - Concept of ‘fast money’ : capital cost recovered in 1 year
 - Regulatory asset life of 20 years to improve cash flow and financeability.
- Capex underspends are shared with consumer through an incentive mechanism.
- Opex overspends are at the expense of the shareholder.
- RPI-X has been very successful.



Annual Report for DNOs

- Purpose – to allow Ofgem to monitor performance against price control obligations and to inform future price controls.
- Under RIIO, also to allow stakeholders to track and compare the DNOs' performance.
- Report on:
 - Reliability and availability
 - Customer Service – Telephone Response
 - Connections
 - Environment – losses, undergrounding in areas of outstanding natural beauty
 - Safety
 - Social obligations
- See circulated scorecard

RIIO



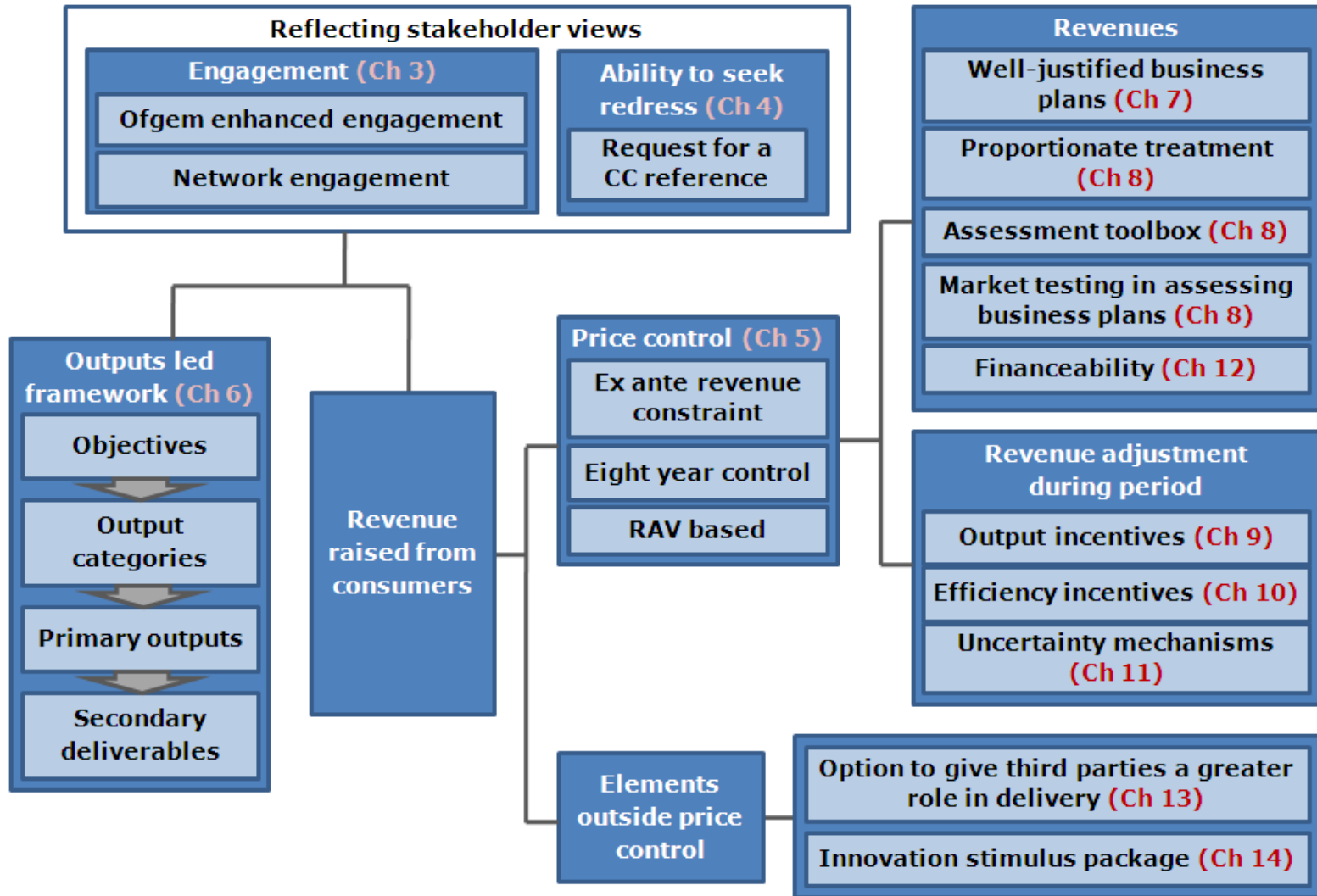
- RIIO: **R**evue = **I**ncentives + **I**nnovation + **O**utputs
- ...encourage network companies to play a full role in the delivery of a sustainable energy sector, and to do so in a way that delivers value for existing and future consumers.
- Value is defined as delivering outcomes that are in the interests of consumers and as efficiently as possible.
- Objective is to drive real benefits for consumers by providing energy network companies with strong incentives to meet the challenges of delivering a low carbon economy and a sustainable energy sector at a lower cost than would have been the case under the previous approach.
- Emphasises stakeholder (including customers) input into the price control process, the networks' business plans and on going business decisions

RIIO



- Networks required to submit well-justified business plans and a Price Control Financial Model that calculates the opening base revenue and incremental adjustments for each year.
- Based on the quality of the business plan, past performance and benchmarking of the forecasted spending to others, Ofgem determines the level of review
- Well performing and cost effective networks are rewarded by being ‘fast tracked’.
- The business plan is assessed based on:

RIIO





RIO - Electricity Distribution

- RIO will be implemented starting in April 2015
- Will be for 8 year period, with review at midpoint
- Continue use of annual indexation based on RPI
- Annual cost of debt indexation
- Pass through of costs outside of the networks; control e.g. Ofgem licence fees
- Mitigating network charging volatility
- Incentives that reward/penalize distributors based on actual performance and expenditure outcomes
- Adjustments due to uncertainty mechanisms for additional costs not provided for in up front allowance



Primary Outputs for RIIO-ED1

Environment	Help to minimise the environment impact of DNO operations and of users by: ensuring low carbon technologies can be connected at a reasonable price and in a timely manner, manage losses, minimize business carbon footprint, minimising material non carbon emissions, using a stakeholder based approach to visual amenity in areas of outstanding natural beauty or national parks, potentially encouraging any role the DNOs might play in Local Authorities' integrated energy schemes.
Reliability	Maintain operation performance for existing and future customers by improving existing health and loading indices and expanding these output measures to include network risk and criticality. Incentivize reliability using the interruptions incentive scheme and guaranteed standards, and have regard to the worst served customers

Primary outputs for RIIO-ED1 con't



Connections	Connect users and suppliers of energy in a timely and cost effective manner and provide high quality information, in a transparent way. Incorporate the societal costs of delays to connection in the output baseline and/or incentive mechanism.
Customer satisfaction	Maintain levels of customer satisfaction through the broad measure of customer satisfaction
Safety	Maintain compliance with Health and Safety Executive requirements
Social obligations	To be discussed. Could include issues such as initiatives to target the fuel poor.