RPI-X@20 Stakeholder workshop

Summary of proceedings

Venue: Hilton hotel, Glasgow
Date: 28 November 2008

In March 2008 Alistair Buchanan announced the RPI-X@20 review, a two year project to review the workings of the current approach to regulating GB's energy networks and develop future policy recommendations. The recommendations of the review will be reported to the Ofgem Authority in summer 2010.

The RPI-X@20 review is now underway and the process of open consultation began with a stakeholder workshop, held in London on 7 November, and a second stakeholder workshop held in Glasgow on 28 November.

The Glasgow workshop was split into two sessions. First, a series of presentations were given by Ofgem and industry representatives. The presentations sparked active discussion amongst attendees on both the process of the RPI-X@20 review and the scope and range of issues that it should address. The slides from these presentations are available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=6&refer=Networks/rpix20/publications/Presentations

In the afternoon, attendees were split into two break-out groups and each was given an issue related to the regulatory regime to discuss. These were:

- **Breakout Session 1:** "Getting the right outcomes" – the group discussed the types of outcomes that the regulatory regime should deliver, whether the current regime delivers against these at the moment and how network companies could be incentivised to deliver against these outcomes going forward; and

- **Breakout Session 2:** "Getting the right framework and process" – the group discussed what the framework should look like and the specific elements required to ensure this regime delivers against its objectives.

A summary of the discussions at the London workshop was also presented. There was an active debate of the associated issues at both of the break-out sessions. Discussions focused on both a review of the RPI-X regime to date and prospective challenges and risks going forward. A nominated spokesperson from each break-out group reported back to all attendees, providing a comprehensive summary of the discussion. These summaries have been written up and are provided below to allow a wider audience to review and consider the issues emerging on the day. The summaries have been cross-checked by participants in each break-out group.

If stakeholders have any comments or questions regarding the summaries below or the workshop more generally, please contact the RPI-X@20 team at RPI-X20@ofgem.gov.uk.

Summary of Workgroup Session Discussions

Breakout Session 1: Getting the right outcomes

The group was encouraged to think about the following questions as part of break out session 1:

- What outcomes should the regulatory regime deliver?
- What mechanisms are in place to deliver these outcomes now?
- What works within the current regime and what doesn't work?
- How can we determine the efficient level and timing of investment?
- How could we monitor network company performance against this?
- Are returns achieved by network companies commensurate with risk?
- Are returns achieved by network companies commensurate with performance in terms of the quality of service provided to customers?
- What future challenges might affect the delivery of desired outcomes? Could the current regulatory regime be adapted to accommodate these?

In terms of the outcomes that the regulatory regime should deliver, the group thought that it would be appropriate to consider this in relation to the outcomes that key stakeholders wanted from the regime. As such, they identified a number of different stakeholders and their associated requirements from the regime, including:

- Customers: They want to receive network services at a reasonable/stable cost and to have the ability to be connected within a reasonable timeframe. There is a potential trade-off between price and stability and, in particular, whether prices are relatively higher and more stable or whether they should be lower and more volatile. In this respect there were questions about who should take the risk of volatility and uncertainty and whether this should be customers, suppliers or network operators. Customers also have a willingness to pay for environmental improvements but this is dependent on the associated cost impact.

- Investors: They are keen to receive a reasonable, risk adjusted return.

- Employees: They want job security, rewards, good training and a safe, well-equipped environment.

- Users: They have a desire for plentiful capacity and the ability to use the network when they want to.

- Network users and generators: They want available capacity at a reasonable cost.

- Government: They desire positive outcomes for voters, security of supply, no big problems on the networks and improvements in environmental performance.

With respect to the mechanisms within the RPI-X regime that had worked well, the group considered that significant improvements in opex and quality improvements had been facilitated. However, they did not think that further gains were evident in terms of opex and suggested that the push toward efficiency may even have gone too far, reducing resource and operational contingency.

In terms of the aspects of the RPI-X regime that had not worked so well, the group pointed to:

- The capex/opex trade-off which had led to companies deferring capex and may therefore be more of an issue in the future. The issue also disincentivises companies from considering alternative approaches to capex involving opex e.g. through the System Operator role;

- The way in which opex is benchmarked may mean that emphasis is placed on reducing costs rather than seeking best practice;

- The difficulty of determining what constitutes reasonable returns on investment, especially in a forward-looking manner where regulation has tended to use history as more of a guide. This is particularly problematic in managing future uncertainty and increased volatility and hence there might be other more elegant ways to deal with this; and

- The inflexibility of the current appeals mechanism and, in particular, the fact that there isn't a mediation solution that would offer a less radical alternative.

With respect to investment under the regime the group recognised that before privatisation the focus was on thinking about where investment would need to be made whereas now the focus was on delivering investment in response to demand signals. There were also questions about whether there were any incentives on network companies to invest ahead of need to avoid network constraints before they got to crunch points. The group were keen that requirements to deliver investment were not codified within the price controls as they had a concern that this could lead to micro-management by the regulator. Rather, they had a preference for Ofgem highlighting the general priority areas for investment from the companies and then monitoring delivery of outcomes. As such, they thought it would be important to develop output measures although they thought it would be key for the measures to be well thought out in order that they did not create any perverse incentives.

The group also touched on the issue of cost of capital suggesting that companies have generally earned a relatively good return relative to the allowed cost of capital but there was a question about how high the returns would need to be to encourage investment. The group recognised that there would need to be an appropriate spread of risk within this. The group questioned how the future could be assessed and emphasised that historical measures are unlikely to be helpful given the changing nature of the risks that will be faced.

There was a discussion about the extent to which network companies should be reactive or proactive in terms of climate change objectives. The incentives may not be that strong at present and therefore may only encourage compliance with minimum statutory requirements. The group considered that the review would need to consider how best to rank and structure the incentives in place to facilitate the desired behaviours from the network companies.

Finally, the group also discussed issues surrounding skills and resources for employees of the network companies as well as the issue of Health and Safety and questioned to what extent these issues should be incorporated within price control considerations.

Break-out session 2: Getting the right framework and process

The following questions were posed to the group as part of break out session 2:

- What key principles should a regulatory regime adhere to?
- Does the RPI-X framework in energy conform to these principles?
- What aspects need to be simplified, if any?
- Is the five-year cycle fit for purpose?
- Are information requirements sufficient or too onerous?
- Should stakeholders have a greater role in the price control process?
- Is the appeals process working? What could be changed?
- Are there concerns about the sustainability of the regime going forward?

The group first asked what the focus of the regime should be. They considered that this should be on the delivery of a good quality service at the lowest cost, but the group recognised that there would inevitably be a trade off between these two outcomes. There was a feeling that customers should be the ones responsible for deciding how these outcomes should be traded off against one another. However, there was a concern that this would be difficult given that customers don't have a strong understanding of the way that the regime works. In addition, the group thought that suppliers or customer groups might not be able to comment on the level of resilience that customers would want from the networks given the wide range of views that a diverse customer base is likely to have. At the highest level, the group thought that many customers might feel that the best network would be one that end-users didn't know about because the costs were acceptable and there were no problems. However, this raises more issues as it would mean that there wasn't any engagement with consumers.

The group noted that often when network companies engage with customers they get a wide range of opinions and customers cannot always be certain over what is wanted in the future. They discussed whether, in line with this, it may be possible to move to a situation in which a range of products are offered to consumers but noted that this would involve changes beyond the regulatory framework (for example, to engineering standards). However, there was an overall feeling that more stakeholder engagement could only be a good thing. In this respect, stakeholders would be able to provide guidance on what was needed and networks (with the regulator) would be responsible for deciding how to implement this.

There was a question within the group as to why this type of engagement was not already taking place and the group observed that it was, to a certain extent, (for example, DPCR5 Stakeholder Engagement); however, the true value of this engagement might not be being realised due to the complexity of the regime. They thought that Ofgem should consider engaging with consumers on the high level principles underpinning policies adopted. They noted that while the regime should aim to be understandable, stakeholders should not be forced, or expected, to understand the detail.

The group identified that an area of conflict currently evident within the regime is related to 'today's issues' as compared with issues that will be encountered in 10 years time. They thought that the networks might need to be more proactive to address a perception that they are simply reacting to what people want today. As a suggested solution, the group thought that the regulatory funding arrangements could be restructured so that the regulator more clearly considers the network companies in two parts: a base element dealing with the day-to-day requirements of the company; and a forward-looking element that would deal with the risks and uncertainty posed by future issues beyond the price control period. The group also discussed the five year regulatory cycle. They recognised that it was there for good reasons but noted that it can make integration and funding of long-term investment planning difficult. They also thought that there was a need to understand the impact of risky investments better, but were unsure as to who should bear the associated risk e.g. network companies, customers, taxpayer.

The group also recognised a further key issue for the review was resolving a conflict in terms of the achievement of security of supply versus the achievement of government environmental policy. Again, the group questioned how these objectives could be reconciled and what Ofgem's role would be within this.