RPI-X@20: “Strawmen” workshop

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Assessment criteria

Framework for deciding whether RPI-X, or alternative regimes, are fit for purpose

The focus should be on whether they deliver outputs/objectives, namely:

- provide value for customers;
- provide stability, certainty and predictability for customers and companies;
- provide efficient companies with financial viability;
- deliver environmental and social policy; and
- ensure security of supply.

Consistency with principles of Better Regulation

Are these objectives/ assessment criteria appropriate?

Improved role for consumers

- Probably make it work in different ways for transmission and distribution – but worth discussing this view

Key features for transmission:

- An enhanced version of the constructive engagement approach used by the CAA for the price regulated airports
- Major customers would agree the key parameters of the price cap (opex, capex, cost of capital, etc) with Ofgem only becoming involved where agreement could not be reached or if it was concerned that unrepresented customers were being disadvantaged
- Customers could agree longer term bilateral deals outside the direct scope of regulation (e.g. inset appointments in the water sector), but governed by general competition law

Improved role for consumers

Key features for distribution:

- The role of consumers would be more limited because of their greater diversity and less obvious "champions" amongst consumers
- Opex and capex could still be determined through constructive engagement, but possibly with mandated rather than voluntary customer representatives
- Some elements of the settlement would still be determined in the current way, e.g. cost of capital
- Ofgem would need to provide more oversight
- To provide further strength to consumers they will also be allowed to appeal regulatory determinations through trade associations, etc

Improved role for consumers

Advantages

- The settlement should better reflect consumers actual requirements rather than regulators' views of their potential requirements
- Consumers will consider carefully their views because they will face the financial consequences
- Reduce the role of the regulator to more of an arbitrator
- More flexible regime for consumers to agree tailored arrangements

Disadvantages

- Consumers may not prioritise investment to meet Government policy objectives, e.g. on the environment
- Important to consider whether the large intermediaries such as suppliers fully represent all consumer's interests
- Gas transmission and UK airports provide reasonably good example of this working with large intermediaries. Less clear it would work well at the distribution level

Increased role for competition: Outline

This model allows for competition in provision of network services, particularly at local distribution level.

It would be similar to idea of local loop unbundling in fixed line telecoms.

At a high level there would be:

- loose regulation of network access charges;
- requirements for existing networks to provide access;
- legal rights for entrants to build alternative networks if they want;
- smart meters and increased own and micro-grid generation.

The aim would be to get competition in provision of energy services at local level

Increased role for competition: Initial thoughts

Examples of competing energy networks are rare but:

- Was the way electricity developed in the C19th
- Ukraine and India both have laws that allow competing second licensees in a geographic area
- IGTs and IDNOs are a step towards this BUT competition for the market not head to head competition

Will technology changes lead to competing min-grids or choosing to go off-grid through self supply change the situation?

Utility bond and contracting out: Outline

This model of regulation applies to both transmission and distribution

Effectively the existing network becomes the core and is treated under a very simple incentive based regime focused on opex efficiency and a minimum required level of finance since it is entirely backward looking

All new capex – whether replacement or enhancement is handled through contracting out

Utility bond and contracting out: Initial thoughts

Examples of this are found quite frequently:

- Use of PPP/PFI type structures for new capex in water and sewerage – Scotland and Northern Ireland
- Use of "Period Contracts" for maintenance etc in Irish gas distribution
- Proposed for airport terminals in Ireland and UK
- Is a variant of what Welsh Water and United Utilities have done through their separation of asset ownership and operation
- Similar to inset appointments in water and IGTs/ IDNOs in energy
- Used extensively outside UK – electricity transmission in Latin America and water and sewerage treatment in China, etc

BUT suffers from the Railtrack problem?

Flexible incentivised

Key features:

- A longer term price control settlement is established – 10 years
- Greater use of revenue drivers and triggers to allow revenues to adapt as investment needs arise
- Caps and collars are used to ensure that returns stay within acceptable boundaries

Example:

- Variants of this approach are used in the US, but generally with re-openers rather than triggers or revenue drivers
- A longer term price control was considered but rejected by Ofwat for PR09

Flexible incentivised - Initial thoughts

Advantages

- Reduce the cost of capital by providing longer term certainty – Might be particularly important in a high investment phase
- Revenue drivers and triggers can be used effectively to react to uncertainty without the costs of re-openers
- Caps and collars for returns avoids the risk of pressure for re-openers
- Reduces the direct costs of regulation through less frequent price reviews

Disadvantages

- A reasonable level of certainty about key drivers for investment is required to set the price control
- Places a lot of emphasis on getting the revenue drivers and triggers broadly right, otherwise re-openers could be required
- Caps and collars on returns could create undesirable incentives at the margins