CEPA

ofgem Promoting choice and value for all gas and electricity customers

RPI-X@20: "Strawmen" workshop

Ofgem, Thursday 22nd January, 9.30am – 1.30pm

Workshop objectives:

1) to discuss merits of potential regulatory regimes ('Strawmen');
2) to test a set of criteria for assessing different regulatory regimes; and
3) to draw lessons for RPI-X@20.

Outline agenda:

9:30 – 10:00	Overview, assessment criteria and plan for the half-day
10:00 – 10:45	The strawmen
10:45	Coffee and tea will be served
10:45 – 12:30	Assessing the strawmen
12:30	Sandwich lunch will be served
12:30 – 13:30	Lessons for future regulation

Chair: Keith Palmer, CEPA

Approach: CEPA describes the strawmen to the group. Everyone 'goes away' to list pros and cons (good or bad elements etc). They also present ideas on potential issues that would need to be considered in designing or implementing the regulatory model. This can be done individually or in a small group (two or three). These ideas are then collated and discussed by the group.

The plan would be to work through the coffee and lunch break to maximise time input while allowing the workshop to finish at a reasonable time.

The strawmen: Four strawmen are proposed:

- Improved role for consumers – constructive engagement/Argentinean out-sourcing/customer contracts;
- Telecoms model – competition for energy services at local level;
- Utility bond; and
- Flexible/incentivised.

CEPA will present stylised descriptions of these models to get the discussion going. There are clearly variations around each of these in terms of how they are designed and implemented but we have to start with something. This is very much a starting point.

Proposed assessment criteria are also provided to allow a common basis for evaluation.

Customer driven regulatory model

Two versions of this model can be proposed – one for transmission and one for distribution.

Transmission

Effectively an enhanced version of airport constructive engagement is envisaged with major customers involved in agreeing general opex and capex (including the allowed rate of return) at each price review. Ofgem would only become involved in a determination if it was apparent that agreement could not be reached or if it appeared that unrepresented customers were being disadvantaged. Similar in concept to negotiated regulatory determinations.

If a major customer wanted to agree a specific long-term deal with the transmission company and effectively move itself out of the regulated sphere (similar to inset appointment in water) then that could be agreed – with specific rules about how shared costs are allocated etc. General competition rules would apply.

Distribution

Here the role of consumers is more limited owing to the greater diversity and potential lack of "champions" among the consumers. Opex and capex would still be subject to constructive engagement but possibly with mandated customer representatives rather than ones that choose to be involved. More oversight by Ofgem will be required and issues like the allowed rate of return would be determined in the traditional way.

To provide further strength to consumers they will also be allowed to appeal regulatory determinations through trade/consumer associations.

Increased role for competition – telecoms model for electricity

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.

Utility bond for core and contracting out new

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. These are effectively PPP/PFI type deals such as have been used in the Scottish and Northern Ireland water industries where fixed long-term agreements are competitively tendered and then treated as pass-through items.

Enhanced and flexible incentive regulation

Under this model:

- a longer term settlement is established – for 10 years;
- greater use of revenue drivers and triggers is made to allow revenues to adapt as investment needs arise; and
- caps and collars are used to ensure that returns stay within acceptable bounds.

This is similar in some respects to some of the US forms of regulation but greater programmed flexibility is created through the drivers – in the US the model would have a re-opener.

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Assessment criteria

We need a framework for deciding how to judge whether RPI-X, or alternative regimes, are fit for purpose. The focus should be on whether they deliver outputs/objectives, namely:

- deliver environmental and social policy;
- ensure security of supply; and
- provide value for customers.

We also need to ensure that the regime is consistent with principles of Better Regulation. Are these objectives/assessment criteria appropriate?