

Potential scope for user participation in the GB energy regulatory framework

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Background

- Report commissioned by Ofgem as part of RPI-X@20 review
- Follows increasing interest in greater user involvement (in several sectors)
- Particular reference to TPCR 5, due to commence April 2012
- Considered relevance of four possible approaches from outside UK energy sector

Options addressed

- They were:
 - public contest method: used in Argentine transmission sector
 - constructive engagement: used by CAA for London and Manchester airports
 - negotiated settlement: used in North American utility sector, especially energy
 - negotiated services: as applied to Australian networks
- Further detail in handout 1

Context

- Included discussion with a few potential participants
 - N Grid, distribution co, AEP (generators)
- Conclusions without prejudice to worthwhile changes already underway
 - Consumer First, business plan engagement under DPCR5, reworking of SO incentive setting processes etc.

Conclusions (1)

Public contest method

- ✓ could help to ensure that future investment programme includes what users want and does not go beyond what users willing to pay for
- ✓ putting expansion projects out to tender could help to ensure lower cost construction
- X would need a change in GB statutory framework
- X could present difficulties in defining a new set of rules for determining votes of transmission users
- X could involve a limitation in the powers of the regulator that could be unacceptable in GB

Conclusions (2)

Constructive engagement

- ✓ flexible and able to focus on those issues where constructive discussion and agreement seem most likely (provided the regulator's specification is not unduly restrictive), leaving to the regulator those issues where agreement seems less likely.
- ✓ would not need any change in GB statutory framework
- X not been without difficulties in UK airports sector
- ± but agreement has been reached on significant elements of airport price controls
- ± lessons have been learned and more robust regulatory framework is being put in place

Conclusions (3)

Negotiated settlements

- ✓ would enable utilities and users to negotiate and agree features of price control of particular significance to them (such as capital expenditure programmes, service quality provisions and incentive arrangements)
- X using such an approach might set unduly high hurdle to overcome if expectation is to deliver agreement on whole range of issues to be covered by a future price control
- ± in practice partial negotiated settlements are sometimes agreed that leave unresolved issues (such as cost of capital) to the regulator
- ± would be necessary to ensure specific measures so that interests of all parties, including Government where appropriate, adequately taken into account

Conclusions (4)

Negotiated services

- ± the Australian negotiated services approach intended to facilitate discussion and agreement for certain services, especially where services have some bespoke element or where different service levels might be feasible
- ± some elements of approach already applied in GB through existing rules for excluded services albeit on a more limited basis
- X would not seem significantly to extend present role of users or customers in the process of resetting GB price controls

Overall conclusions

- All four options have points of benefit or relevance to RPI-X@20
- Generally more pros than cons – see handout 2
- There is scope to increase user involvement in general and in TPCR5 in particular
- Constructive engagement seems most promising, at least in GB transmission context
 - Encouraging precedent in GB
 - Can deliver benefits of negotiated settlements (provided definition of roles reflects views of participants)
 - Wider application (eg to distribution) not ruled out
- More research into development & application

Implications

- To enable constructive engagement in the sector Ofgem would need to (inter alia):
 - provide greater clarity on roles, especially its own, and on timetables and procedures
 - consider adequacy of user representation
 - facilitate discussion through more information (e.g. publication of licensee business plan)
 - indicate any conditions and boundaries
 - establish default process

Handout (1)

Summary of approaches

Method	Main area of application	Nature of process	Status of outcomes
Public contest method	<p>Argentina: electricity transmission (new investment).</p> <p>Project by project (>\$US2mn), initiated by users within specified regulatory framework.</p>	<p>Users propose and vote for expansion projects, with votes based on first two years of expected usage.</p> <p>Construction, operation & maintenance of approved projects put out to competitive tender.</p> <p>In a provincial sub-transmission network, users have agreed a ten year investment plan to identify eligible schemes.</p>	<p>Binding on parties, not open to change by regulator.</p>
Constructive engagement	<p>UK: airport price control reviews.</p> <p>Application & scope proposed by regulator. CAA suggested stakeholders focus on traffic forecasts, quality of services and capex.</p>	<p>Content of agreement then subject to wider consultation by the regulator as part of process of price setting.</p> <p>Failure to agree means default to traditional price control process.</p>	<p>Regulatory discretion as to how far to take account of agreement, but in practice areas of agreement have been largely incorporated.</p>
Negotiated settlement	<p>US, Canada: utility sector, especially energy.</p> <p>Coverage at discretion of the parties, typically rates or tariffs with some extension to issues such as investment projects, quality of service and incentive schemes.</p>	<p>Some regulators have encouraged negotiated settlements, others have not.</p> <p>Some US consumer groups have been critical of settlements.</p> <p>Failure to agree means default to traditional regulatory process.</p> <p>Where appropriate regulators have facilitated participation of smaller interested parties.</p> <p>In Canada, regulator has sought to facilitate negotiated settlements by providing direction on key financial parameters (cost of capital).</p> <p>In Florida, the Public Counsel has been a major participant.</p>	<p>Agreements are binding on the parties but subject to a regulatory finding that rates are just and reasonable.</p> <p>In practice the settlement is usually accepted by regulator.</p>
Negotiated services	<p>Australia: electricity transmission and distribution.</p> <p>Third party services and site-specific terms for both electricity distribution and transmission.</p> <p>Slightly different coverage for transmission and distribution.</p>	<p>Considerable prescription of procedures and negotiating parameters is set out in the National Electricity Rules.</p> <p>The network service provider must publish guidelines and negotiating principles.</p> <p>Arbitration is by the regulator for distribution and an external expert for transmission.</p>	<p>An agreed settlement is achieved on the negotiated service or services.</p> <p>The network user accepts the proposed offer or refers any disagreement to an arbitrator.</p>

Handout (2)

Summary of pros and cons

Method	Pros	Cons	Other comments
Public contest method	<p>Investments are user driven—there is a clear trigger. This creates a presumption that design and timing of investment programmes would be efficient.</p> <p>No stranded asset risk.</p> <p>Clear methodology for allocating costs.</p> <p>Evidence that competitive tender has produced significantly lowers costs.</p> <p>Reduction in role of regulator.</p>	<p>Would require legislative changes in GB.</p> <p>Reduction in role of regulator could cause concern to some stakeholders.</p> <p>Cost allocation rules could be more difficult in meshed system.</p> <p>Raises wider issues:</p> <ul style="list-style-type: none"> ▪ reversion to deep charging? ▪ compatible with current or proposed access regime? 	<p>About 25 applications over about 15 years, albeit constrained by macro-economic crisis and partially superseded by government-initiated transmission expansions.</p> <p>Geared to individual projects but can be consistent with longer-term transmission development plan.</p>
Constructive engagement	<p>Allows regulator to invite service users to negotiate on issues where regulator considers this will be productive.</p> <p>Allows parties to focus on aspects of greatest importance to them.</p> <p>No legislative change needed in GB.</p> <p>Could add significantly to scope of user participation in traditional price control setting.</p> <p>Evidence of improved information provision and understanding at main BAA airports (albeit with some qualification).</p>	<p>Allocation of issues by regulator may unduly constrain parties.</p> <p>Uncertainty over regulatory ‘buy-in’, or attempts to influence regulator, may discourage participation and negotiation.</p> <p>There have been concerns about information provision, ‘capex creep’, lack of arrangements for arbitration in event of failure to agree, and preservation of interests of future users and the public interest.</p> <p>Application beyond airports needs consideration, as does question of how to involve all relevant users.</p> <p>And the issue of how to bring to bear governmental concerns or wider public interest considerations also needs to be addressed.</p>	<p>Limited and mixed track record.</p> <p>Wider scope could require development of more comprehensive procedures and guidelines.</p> <p>Would require clearer demarcations on scope and residual role of regulator.</p> <p>Post agreement process could necessitate wider third party engagement to ensure appropriate levels of consultation.</p>
Negotiated settlement	<p>Allows service users (including final consumers) to determine issues of importance to them.</p> <p>Possibility of part settlement means that approach does not depend upon participants agreeing all outstanding issues.</p> <p>Flexible—has taken a number of forms to suit requirements of participants.</p> <p>Evidence of substantial achievements and benefits for users, including final consumers.</p>	<p>Mixed views have been expressed about merits of settlements.</p> <p>Some concerns in some US jurisdictions that:</p> <ul style="list-style-type: none"> ▪ ordinary consumers could be worse off, ▪ settlements mean less transparency, and ▪ regulators ought to determine such issues as a matter of principle. <p>How to involve all relevant parties needs to be considered.</p> <p>And the issue of how to bring to bear governmental concerns or wider public interest considerations also needs to be addressed.</p>	<p>Approach has been applied in N America in a wide range of circumstances over a long period of time.</p> <p>Requires positive encouragement and clarification of stance of regulator.</p> <p>Process involving wider engagement of specific types of stakeholder might necessitate further third party engagement to ensure all interested parties are consulted.</p>
Negotiated services	<p>Provides for bespoke services and therefore flexibility.</p> <p>Permits choice as users can stipulate quality levels on dedicated services, upgrading service or lowering costs.</p> <p>Consequently may stimulate innovation.</p> <p>Delivers greater engagement of service users.</p>	<p>Does not help with reset of conventional price control, which is the focus of the RPI-X@20 review, and therefore would have marginal application.</p> <p>Choice is offset by high level of prescription for parameters of negotiated deal.</p> <p>Does not accommodate end consumers.</p>	<p>Similar application already exists in Britain through excluded services regime, albeit in less prescriptive form.</p>