

Stakeholder workshop: RPI-X@20 Current Thinking

16 October 2009

Welcome and introduction

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Purpose of today's workshop

Provide an overview of our current thinking on RPI-X@20

Hear your views in relation to our current thinking

Get your ideas on how RPI-X@20 might progress

What is RPI-X@20?

- RPI-X has been used to regulate GB energy networks for nearly 20 years
 - RPI-X@20 is a 'root and branch' review of the regulatory regime
 - We will develop recommendations for a future regulatory framework

What are the drivers of the review?

Good housekeeping

New and emerging challenges

Simplification?

The first consultation document was published in February

**Identified 2 themes
for the review**

1. Focusing on consumer needs
2. Delivering a sustainable energy sector

The document was an issues paper – no proposals or decisions

What have we done since February?

8 working papers on our web forum over the summer setting out our current thinking:

Our first paper explored what a future regulatory framework should deliver

We published papers exploring how these outcomes could be delivered

Innovation

Consumer engagement in the regulatory process

What do we mean by efficiency?

Enhancing competitive pressures

A modified ex ante framework

Ensuring regulatory frameworks are adaptable

Who decides what energy networks of the future should look like?

Commissioned consultancy reports and facilitated RPI-X@20 working groups

Many thanks to the working group members for their hard work and commitment

Ongoing stakeholder engagement

Engaging with other regulators

Network regulation in other industries

Network regulation in other countries

Engaging with academics

Academic workshop

1 to 1 meetings

Consultancy advice

Engaging across industry

Workshops

Working groups

Web forum

Advisory board

Engagements with LUG and SMUG

Engaging with government

DECC, BIS, DfT

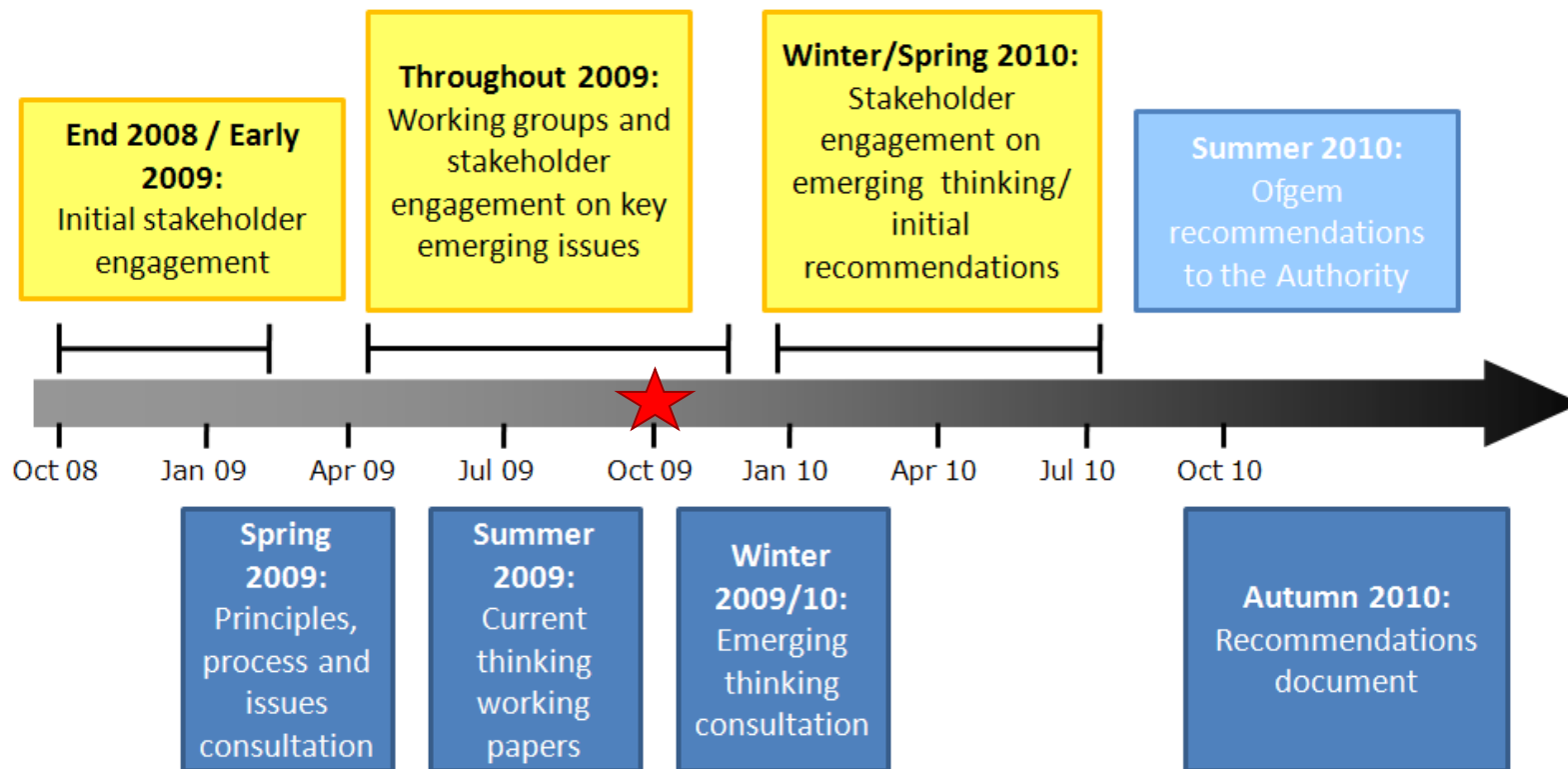
Engaging with consumers

Consumer challenge group

Consumer First Panel

We continue to work with other teams on key overlapping areas of policy

Way forward



Our thinking on the regulatory frameworks will be further developed as part of the work for emerging thinking

Emerging Thinking is key consultation

Emerging thinking will set out

What we want to deliver

How we think it can be delivered

A core framework applicable to gas/electricity/transmission/distribution

- Elements specific to certain sectors given the inherent differences
 - We will explain what we are doing and why
 - We will also explain why we are not adopting other models

Next steps and way forward

Consultation planned for publication in Winter 2009

12 week period planned for consultation

Post winter: we will work up detail, which could change assessment

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Overview of our working papers

Cloda Jenkins, Head Regulatory Review

Our working papers have focused on key questions

What do we want networks and the regulatory framework to deliver?

Who decides what needs to be done?

How do we encourage the right outcomes from the networks?

Ex ante framework?

Ex post framework?

Competitive pressures?

Is a specific stimulus needed to encourage innovation?

What role should consumers take in the regulatory regime and should they have a right of appeal?

How do we adapt and manage uncertainty?

Will the role of networks need to change?

**Emerging Thinking will also look at financeability
Working closely with local grids, transmission and other projects**

What should the regulatory framework deliver?

What is the issue?

- To develop an effective regulatory framework for the future we need clarity on the outcomes we expect networks to deliver
- A clear statement of purpose provides us with a basis to assess the current framework against possible alternatives

What have we done

- Developed a working paper setting out our initial thoughts
- The working paper was informed by a review of:

Relevant legislative and regulatory provisions

Emerging EU and UK energy policy

Stakeholder views expressed through RPI-X@20

Developed thinking on what some of the behaviours that will facilitate these outcomes might mean e.g. efficiency

What is our current thinking?

An effective future regulatory framework should encourage networks to focus on needs of existing and future consumers by:

Playing a full role in facilitating delivery of a sustainable energy sector

Security of supply	Safety : e.g. gas mains replacement	Environmental targets: Low carbon; Greenhouse gases
Specified social targets		Quality of service: E.g. consumer experience

Providing value for money over long term

➤ **Emerging thinking will provide further clarification**

What is efficiency?

What is the issue?

- Our outcomes paper outlined that the regulatory framework should reward networks that deliver desired outcomes efficiently
- We need to have a mutual understanding of what we mean by efficiency, taking account of uncertainty

Developed a working paper setting out our current thinking on the issue.

The working paper recognised that there is a perception that networks:

Are focussed on the short-term

Do not consider alternative scenarios and impact of choices on future options

Are focussed on the delivery of an 'agreed' plan rather than adapting to changing situations

This may impact upon delivery of value for money over time

What might a new efficiency definition look like?

Networks should deliver outcomes/outputs efficiently over long term

- Restrain costs over long term
 - Keep options open but not at the expense of delivery or value for money
- Make efficient choices between best use of existing assets, adapting and adopting new technologies, and building new assets

What may need to change to facilitate achievement of this objective?

Output measures

- Desired outcomes not always fully translated to output measures
- Link between outcomes and cost not always clear

Assessment of efficient expenditure

Perception that definition of 'economic and efficient' is narrowly focused

Incentives

- Short term focus
- Differential treatment of cost savings
 - Can distort decisions
- Range/nature can be complex

Emerging thinking will provide further clarification

Who decides what future networks look like?

Networks need to contribute to delivery of sustainable energy sector

- Uncertainty on future network role and direction
- Regulatory framework cannot be source of delay of delivery

Range of views on how this issue should be addressed

**Central government-
led model**

**Joint industry led
model**

**Adapted regulatory
framework**

Working paper explored each of these options and recognised that any of these could emerge

**Next
steps**

Need to ensure that the regulatory framework would be robust to the emergence of any of these models

What form should the regulatory framework take?

There is a range of forms that the overarching regulatory framework could take

**(Modified) ex ante
framework**

**Ex post
framework**

**Enhancing competitive
pressures**

Need to assess which framework will facilitate the delivery of the desired outcomes most efficiently and effectively – not mutually exclusive

**How has our
thinking been
informed?**

- Commissioned an LECG paper on the merits of ex post
- Published a paper looking at the potential lessons for energy networks from telecoms regulation
- Commissioned a paper looking at the practical barriers to the emergence of energy services companies and implications for consumers and regulation
- Published working papers on 'A modified ex ante regime' and enhancing competitive pressures

What might a modified ex ante regime look like?

Published a working paper looking at these issues

Three main aspects to the proposed modified ex ante framework

1. Output setting

- More extensive
- Related to desired outcomes

2. Richer business plans

Long-term horizons, scenario planning, recognising needs of other parties

3. Incentives framework

- Incentivise efficient delivery and rich plans
- May develop over time

- Findings of consultant report recommended against ex post regulation for energy networks on the basis of theory and practical examples explored
- Concerns that it would not sufficiently protect consumer interests, effectively support investment or reduce regulatory burden

Emerging Thinking will provide further clarification on ex ante v ex post and more on preferred option

Enhancing competitive pressures

Issue: Could greater competitive pressures deliver better value for money or better facilitate the transition to a sustainable energy sector?

Two themes:

Enhancing competitive pressures to drive efficient delivery of outcomes at the network level

Ensuring networks are not a barrier to the development of competition in the retail market or effective competition in the market to build and maintain new connections

1. The regulatory framework should not create unnecessary barriers to competition
- 2. Competitive tendering emerges as a potentially desirable complement to our existing regulatory tool-kit**
3. Neither the regulatory framework nor behaviour of networks should pose an unnecessary barrier to emerging innovative business models e.g. ESCOs

How can more innovation be stimulated?

What is the issue?

- Evidence suggests that the level of network innovation has been declining since privatisation
- We think that innovation on the networks will facilitate the efficient, low cost delivery of the sustainability targets

To better understand the issues we have

- Commissioned a KEMA report on technical network innovation
- Published a working paper setting out our emerging thinking on the issue

Current thinking

- Enhanced competition and a modified regulatory regime may stimulate innovation but not in time for 2020 and 2050 targets
- A time limited innovation stimulus is needed to support the step-change in innovation to meet the 2020 and 2050 targets
- This will build on the RPZ, IFI and low carbon networks fund

What should an innovation stimulus look like?



Eligibility	Networks	Certain third parties	All parties
Network applicability	Individual networks	Networks in one sector	All sectors
Forms of innovation	Specific forms	Differentiated applicability	Applicable to all forms
Qualification for funding	Application for funding	Approval for funding	Submit bids for Competition
Governance	Self governance	Industry group/Ofgem	Independent panel
Fund availability	Limited	Partial funding	Full
Treatment of benefits	No regulatory intervention	Stakeholders share benefits	Benefits to stakeholders
Assessment	Ex ante	Regular monitoring	Ex post

- Building on existing mechanisms, there are a range of features of an innovation scheme
- Must not crowd out innovation that would have taken place

Emerging Thinking will provide further ideas on the form of the innovation stimulus

Role of consumers in the regulatory regime

February consultation recognised focussing on consumers as a key theme

Do we need more engagement with consumers to facilitate this?

Effective engagement could deliver a more informed regulatory package, improve the legitimacy of the regime and improve consumer understanding

Recognition that price control engagement has increased, notably in DPCR5

BUT there is a rationale for increasing consumer engagement now:

Cost increase

Environmental decisions

Concerns over regulation

Complexity

How has our thinking on this issue been informed?

- Commissioned a paper looking at consumer participation in other regimes
 - Held a session on these issues with the consumer challenge group
- Explored domestic consumer understanding of energy using the Consumer First Panel
 - Published a working paper setting out our current thinking

What form might engagement take?

Informing decisions

Part of decision-making process

Agreeing certain parts of settlement

- Consumer reps/users and networks in a room to discuss with governance from Ofgem
- Consumer rep understanding will develop over time to better equip them for decisions
 - Reps need to engage more effectively with consumers to understand their views

We will work up the detail of this as part of the emerging thinking document

We are also assessing the case for introducing a third party right of appeal

- LECG were commissioned to assess the case for this
- Concluded that a right of appeal for third parties desirable, if appropriately designed

Improve our
accountability

Provide incentives
to engage

Equalise the
balance of power

Improve quality of
regulatory decisions

We will assess the case for this as part of the process toward emerging thinking

Adaptability

The scale of uncertainty networks currently face is arguably unprecedented

**Regulatory framework
needs to be able to**



**Adapt during a
regulatory period**

**Adapt between
regulatory periods**

The current regulatory regime has successfully adapted over time

By making changes to the
regime at periodic reviews

- Reopening price controls via our financeability duty
- Using specific tools e.g. revenue drivers

Questions...

Are tools, to reduce networks' exposure to uncertainty, needed on top of financing duty? If so, when should they be used?

A full re-opener of the price control: do we need something more explicit than our financing duty alone?

The role of future energy networks

Commissioned a report from Frontier on the role of future energy networks

- The report focuses on whether the current role and structure of energy networks could act as a barrier to effective and efficient regulation
- The report looked at these issues in relation to electricity T and D

Key findings

Distribution

- Potential barriers to supply side response due to absence of a relationship with generators
- Potential barriers to demand side response due to absence of a relationship with consumers
- Current incentives may create barriers to efficient choices between network investment and active demand management

Transmission

To encourage efficient decision making on investment in assets and network management, the report recommended changes to the incentive framework rather than required splitting of TO/SO functions

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Way Forward

Cloda Jenkins, Head Regulatory Review

Way Forward

Emerging thinking planned for publication in Winter 2009

- The consultation will develop our thinking from the working papers, building on

Stakeholder engagement

Working groups

Consultant reports

- 12 week period planned for consultation
- Keen to hear your views on the proposals in this consultation

- Post emerging thinking we will develop detail on the way the regulatory frameworks will operate based on responses and engagement to date
- There will be opportunities for ongoing engagement on these issues prior to presentation of our final proposals to Authority in Summer 2010

Continue to welcome contributions to our web forum

- On working paper issues or other topics

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

ofgem

Promoting choice and value
for all gas and electricity customers