

## Regulating energy networks for the future: RPI-X@20 Emerging Thinking - Enhanced engagement

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**Target audience:** Consumers and their representatives, those with sustainable development interests, energy transmission and distribution companies, generators and offshore producers, suppliers, shippers, Government, investors, academics and other interested parties.

### Overview:

RPI-X@20 is Ofgem's detailed review of energy network regulation. We are looking to the future on behalf of consumers by considering how best to regulate energy network companies to enable them to meet the challenges and opportunities of delivering a sustainable, low carbon energy sector whilst continuing to facilitate competition in energy supply. There is considerable uncertainty about how best to meet these challenges whilst maintaining value for money for existing and future consumers.

We want to encourage network companies to focus on the needs of existing and future consumers. To do this we think that they need to engage more effectively with their consumers. We recognise that Ofgem could also make improvements in how we engage with stakeholders. This supporting paper, published in parallel with our main Emerging Thinking consultation paper, provides further detail on our emerging thinking on enhanced engagement between networks, Ofgem, consumers, network users and other stakeholders as part of the regulatory framework.

We welcome views on this supporting paper.

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## 1. Introduction

1.1. RPI-X@20 is Ofgem's detailed review of energy network regulation, enabling us to step back and look to the future on behalf of existing and future consumers. Our Emerging Thinking consultation documents set out, for consultation, a potential new regulatory framework for energy networks.

1.2. Our Emerging Thinking consultation paper attempts to provide an accessible overview of our emerging thinking and is aimed at a wide range of interested parties. Our ideas on 'embedding financeability in a new regulatory framework' are discussed in more detail in a parallel consultation paper. We will also shortly be publishing a related consultation paper on whether we should introduce a third-party right to challenge to our final price control decisions, as some participants in the review have advocated.

1.3. This is one of a series of technical supporting papers that provide further details on key aspects of the new framework. These supporting papers are aimed primarily at the network companies, investors and other stakeholders who require a more in depth understanding of our thinking and the rationale underpinning it in some or all areas. References for these papers can be found in Appendix 10 of our main Emerging Thinking consultation paper (<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/embedding%20thinking.pdf>).

1.4. Traditionally determination of the regulatory settlement has primarily involved ongoing discussion between Ofgem and the network companies, with opportunities for others to engage via formal consultation routes. However, since privatisation, mechanisms have been developed to facilitate more effective engagement and, since DPCR3 when we undertook engagement with domestic consumers, we have sought increasingly to engage consumers in the process. Mechanisms include quantitative and qualitative consumer research, the piloting of a Consumer Challenge Group for DPCR5<sup>1</sup> and the use of more deliberative methods via the Consumer First Panel<sup>2</sup>. While we recognise the increasing opportunities for consumer engagement during the price control, we think that scope remains to enhance this engagement further.

1.5. We think there is a case for network companies to undertake more engagement with their stakeholders on an ongoing basis. This would help ensure that they have a better understanding of the views and needs of their consumers and users of their networks, thereby allowing them to consider how they can best deliver against these. Our thinking on this is set out in the main Emerging Thinking consultation document and further details on the incentives that would underpin this are provided

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<sup>1</sup> The interim report from the consumer challenge group provides more information and is available from: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=20&refer=Consumers/CF>

<sup>2</sup> Further information regarding the Consumer First panel and notes from the panel sessions are available from: <http://www.ofgem.gov.uk/Consumers/CF/Pages/CF.aspx>

in our supporting paper on incentivising efficient long-term delivery of desired outcomes.

1.6. This paper focuses on the role that we could play in facilitating more effective engagement with network consumers and other stakeholders during price controls.

1.7. A forthcoming parallel consultation document will explore the case for introducing a third-party right to challenge the final proposed regulatory settlement as a complement to ongoing engagement throughout the price control process. We think this could have the potential to encourage stakeholders, network companies and us to engage effectively throughout the price control process. It may also help to improve our accountability with respect to the price control decisions that we take. However, we note the potential for the establishment of a third-party right to challenge to lead to an increase in the number of legal challenges raised and to introduce uncertainty and delay into the process. We are keen to hear the views of interested parties regarding the potential establishment of such a mechanism.

## 2. Rationale for enhanced engagement

2.1. Our principal duty is to protect the interests of existing and future consumers. To discharge our duty effectively, it is important that we understand the interests of existing and future energy consumers, and that the regulatory framework encourages network companies to meet their needs

2.2. As set out above, since privatisation the opportunities for consumers to engage in the development of the final regulatory settlement have significantly increased. This was of particular note under DPCR5. However, RPI-X@20 has highlighted a perception that it can be difficult for network consumers to engage meaningfully in the price control process. Therefore the scope remains for us and the network companies to do more in terms of providing opportunities for consumer engagement.

2.3. In light of the challenges that the network companies are currently facing, we think that more targeted opportunities for effective engagement may be needed to ensure that the views of network consumers are effectively represented during the development of the regulatory settlement. These challenges relate particularly to the role that network companies may play in facilitating the transition to a low carbon energy sector<sup>3</sup>. We anticipate this is likely to lead to an increase in costs for consumers and that consumers should therefore be able to influence the direction of policy, the priorities identified for regulation and the outcome of price control reviews.

2.4. We recognise that the conditions for effective engagement may vary across the network sectors. Our initial thinking on the considerations that may need to be taken into account in designing mechanisms for enhanced engagement in each of the energy network sectors is set out in our working paper on consumer engagement in the regulatory process.

2.5. We expect that, where engagement is effective, this would:

- increase the perceived legitimacy of the framework from a consumer perspective;
- encourage network companies and the industry more widely to take more responsibility for decision making; and
- provide us and network companies with a better understanding of what needs to be delivered.

2.6. In our Emerging Thinking consultation document, we set out a potential new regulatory framework that puts sustainability alongside consumers at the heart of what network companies do. This regulatory framework would:

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<sup>3</sup> These challenges are set out in more detail in our "RPI-X@20 Emerging Thinking" consultation document.

- Focus on the delivery of outcomes and outputs related to safe, secure, high quality and sustainable network services at value for money;
- Retain and strengthen incentives on companies to constrain the cost of delivery over the long term;
- Provide commitment for at least some elements of the regulatory package for longer than five years;
- Encourage network companies to consider different approaches in the development of their business plans, removing biases towards capital intensive solutions and rewarding innovative charging;
- Take a proportionate approach to the regulatory process, with depth of scrutiny dependent on a company's reputation for planning and delivering efficiently; and
- Ensure network companies earn appropriate returns for their performance and the level of risk they face. Inefficient companies would not be bailed out.

2.7. We think that emphasis on the use of output measures and the development of 'well-justified business plans', may facilitate constructive dialogue on development of the networks. Engagement in this way may also improve industry understanding and cooperation in facilitating the transition to a sustainable energy sector.

2.8. We think effective consumer engagement would be best achieved by encouraging network companies to engage with consumers on an ongoing basis and complementing this with our own enhanced consumer engagement as part of the price review process.

### 3. Overview of Ofgem's enhanced engagement process

3.1. This section sets out our emerging thinking on the process for enhanced engagement, including the way that it could act as a complement to the existing consultation process, the parties that may seek to participate and the fora that could act as an input to this process.

3.2. We think that there is a role for the network companies to play in actively engaging with their consumers, users of their network and other stakeholders on an ongoing basis, not just during the course of price control reviews. As such, as part of any new regulatory framework, they would be expected to demonstrate effective engagement with their consumers and network users in their planning and delivery. They would also need to show due regard to the views expressed by their consumers and network users during this process. Evidence of effective engagement would be needed if we were to agree to output proposals and other aspects of network company business plans. This builds on what was required from the electricity distribution network companies in the recent price control review.

3.3. Network companies that put effective engagement at the centre of how they plan and deliver would be rewarded. The reward options that we are considering are discussed in our supporting paper on incentivising efficient long-term delivery of desired outcomes.

3.4. We think we also have a role to play in ensuring that network companies retain a focus on the needs of their consumers and network users. Our working paper on consumer engagement in the regulatory process outlined several options that could be developed to encourage greater stakeholder engagement in the regulatory process. Our early conclusion was that we did not think it would be appropriate to adopt an approach that gives the network companies and their stakeholders responsibility to negotiate directly on certain elements of the regulatory framework. Rather, we suggested it would be more appropriate to provide affected parties with opportunities to influence the outcome of the price control through an enhanced engagement model. This approach would enable stakeholders to meet regularly during the price control process to discuss key issues and share views on the development of the regulatory settlement.

3.5. We think that all parties affected by the outcome of the regulatory settlement should have an opportunity to engage effectively in the price control review fora. We think that this would deliver the most benefit in terms of ensuring the development of a more informed regulatory settlement. These groups include:

- domestic consumers;

- domestic consumers (individuals<sup>4</sup> or groups of consumers), small and medium enterprises (SMEs), industrial and commercial consumers (I&C), and representatives of each of these consumer groups;
- suppliers, generators, shippers and other users of network services such as interconnectors, independent network operators and independent connection providers;
- network employees and their representatives;
- Government;
- other regulators, including the Health and Safety Executive and where appropriate other European regulators including the EU Agency (ACER);
- investors and their representatives; and
- other special interest groups (e.g. environmental groups).

3.6. We think that the establishment of a price control review forum allowing affected parties to participate at specific stages in the development of the final regulatory settlement could facilitate more effective engagement with all of these parties. These price control review fora would be held at regular intervals throughout the development of the regulatory settlement, with an open invitation for interested parties to attend and take part. This approach would enable stakeholders to articulate their views on policy issues and facilitate a more holistic understanding of views across the various parties and the rationale underpinning these.

3.7. There are a number of existing fora that could be used as inputs to feed into discussions at these price control review fora. Using these could reduce the additional regulatory burden for parties, particularly consumer groups, wishing to engage. These existing fora could be used for early discussion prior to the overall price control review fora to allow an open exchange of views between stakeholders with common interests and to facilitate the development of an agreed position on proposed policy issues. These views would then be fed into the price control review forum representing a multi-layered approach to engagement.

3.8. There are also a number of existing measures that could be further developed and used as inputs to the price control review fora, complementing the inputs from existing fora. Our existing suite of tools, including market research, the Consumer Challenge Group, and the Consumer First Panel could be enhanced and extended to further ensure that the views of all stakeholders were fed through to the price control review fora. In addition, our 'traditional' consultation processes could be improved by making information more accessible and easier to understand, and potentially by targeting workshops and seminars to particular interest groups.

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<sup>4</sup> Individual consumers are unlikely to engage on all aspects of the review but we can use market research and our Consumer First Panel to understand their needs better. Consumers may be more interested in engaging in the future. This may happen, for example, if networks have more to do with consumers, potentially through smart meters and smart grids and through effective engagement, and consumers understand better the implication of rising network charges for their energy bills.



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## 4. The price control review fora

4.1. This section sets out our emerging thinking on the way that we think enhanced engagement could work as part of a price control. However, we do not want to set in stone any process for this type of engagement. Rather, we are keen to establish principles for engagement which could be adopted during price control reviews, with the potential for these to adapt to the specifics of the price control under consideration and evolve over time. The following section is therefore intended to provide an indication of the way that enhanced engagement could work.

4.2. We envisage that there would be three key phases of the price control review fora during the process of developing the regulatory settlement.

- **Phase 1:** The first phase would be held prior to publication of our initial consultation document on the price control review. It is likely that this phase of meetings would focus on agreeing terms of reference and ground rules for enhanced engagement. However, the focus of these meetings is likely to be on the issues that stakeholders would like to discuss at the price control review fora throughout the period of the review. We note that the issues discussed would not need to be technical price control issues but rather could be based around the outcomes that stakeholders wanted to see from the network companies. Holding discussions on areas of interest to stakeholders at an early stage in the process would help ensure that discussions at the price control review fora were focused on issues of importance to the parties involved and in areas conducive to debate. We note that the possibility should exist, however, for the focus of discussions to be amended in the event that new issues of importance were identified.

Our current thinking is that more constructive dialogue is likely to take place on issues such as the design of outputs/incentives or on options included in the richer business plans, rather than on the specifics of the business plans or the weighting of the output measures. However, as understanding of the issues improves over time and the price control review fora are streamlined, these issues could potentially be discussed. We envisage that this first phase of meetings would also provide us with an early indication of key areas of interest and allow us to set out our expectations for the outcomes of the process.

- **Phase 2:** The second phase of meetings would be peppered throughout the process of the review and would likely be held prior to publication of major consultation documents. As the issues for discussion and terms of reference for the group would already have been set in phase one, this second phase of meetings should facilitate dialogue regarding stakeholder views on policy issues under development.
- **Phase 3:** The final phase of the price control review fora would likely comprise one meeting, to be held prior to publication of the final proposals. This would provide affected parties with a final opportunity to influence the direction of policy. It may also facilitate engagement on aspects of policy that may not have been developed until later in the process. We think that holding a final meeting

at this stage in the process represents a key change in the focus of engagement through the price control process as historically this period has been focused on discussions between Ofgem and the network companies.

4.3. We think it would be beneficial for all parties seeking to engage in this way to have clarity on the process and timetable associated with the price control review fora. Interested parties would, as a result, be able to manage their own resource more effectively, allowing them to plan the meetings that would act as inputs to the price control review fora at appropriate times.

4.4. At each of the stages a record of the meetings could be published to facilitate transparency regarding the issues discussed. This would help to improve stakeholder understanding of the price control process and provide transparency on the views of the parties taking part in the price control review fora.

4.5. We recognise the potential for this type of engagement to impact upon the overall timetable for the review but think, as far as possible, the price control review fora should be planned around milestones in the control to ensure that they do not unnecessarily extend the period of review. To some extent, this may also be facilitated by effective governance of the meetings to ensure there is structure to the sessions and that all of the issues, of importance to the groups involved, are adequately discussed.

4.6. We think that strong governance of these sessions would be needed to ensure there were opportunities for all participating parties to be heard within the process. This would also enable us to obtain a clear understanding of the views of all parties with respect to the various issues under discussion. Our current thinking is that we would be the most appropriate party to govern the process. As the Authority is the final decision maker in relation to price control decisions, Ofgem would be well placed to manage this process and ensure that consumer views are taken into account. We therefore envisage that a senior Ofgem representative would be responsible for chairing these meetings.

4.7. As a complement to this, we would need to manage the processes to ensure that we engaged in the most effective ways with different parties. We also note that the interests of these groups would not necessarily be aligned with each other, or indeed not all groups would be aligned with the interests of existing and future end consumers. We would therefore have a clear role in balancing a range of different interests in line with our duties. It is nonetheless important that we understand what these interests are, identifying where there is agreement and where there is not.

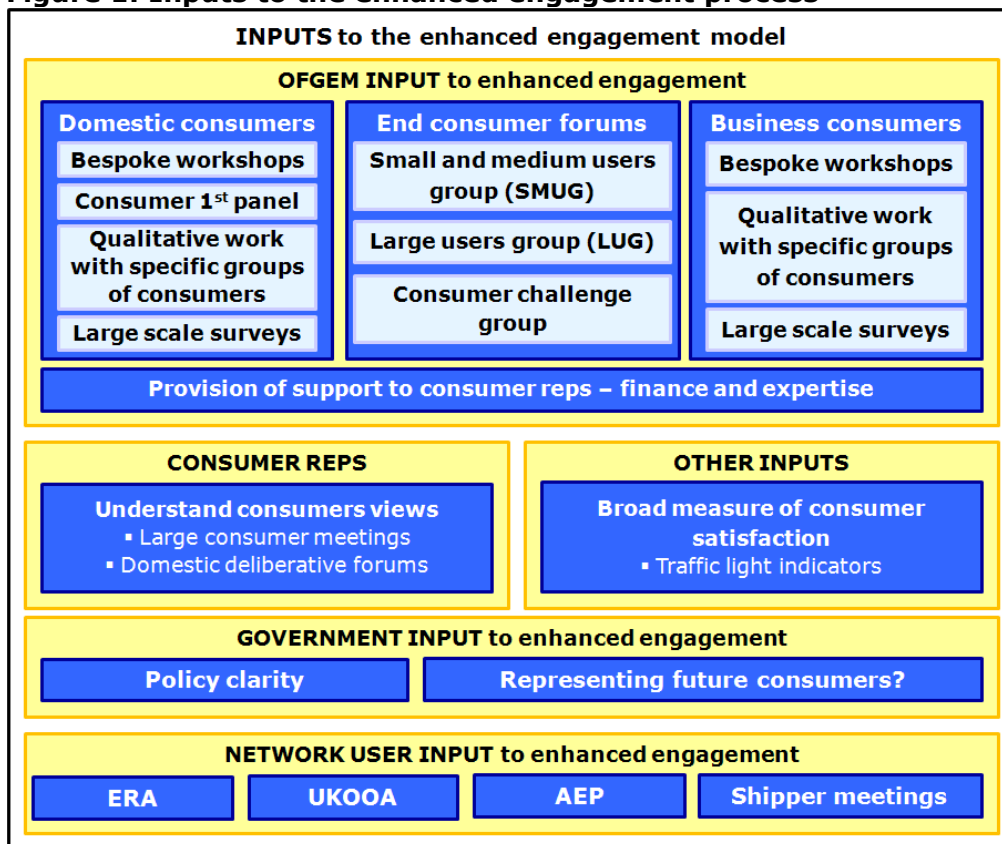
4.8. The extent to which different groups engage in the process would likely depend on the extent to which any specific price control review impacts on them, and on their own access to resources and expertise to enable them to engage effectively. We envisage situations where some groups engage with us, others engage with the company that provides their network services and others engage with both.

## 5. Complementary measures to the price control review fora

5.1. We think engagement should be multi-layered to allow established groups, for example the large users group (LUG), and their associated meetings to be used as inputs to the price control review fora. We note that these groups have not been established specifically to feed into the price control review process but could provide the range of interested parties, outlined above, with clear opportunities to engage. This suggests a need for us and the other parties involved in this engagement to be mindful of the range of other policies and issues that may also need to be discussed at these meetings. There is also a need for the views of future consumers and network users to be represented and we think there is a role for us to play in performing this function.

5.2. Given the range of parties that have an interest in the regulatory settlement, we think that there are a number of existing fora that would be used to feed into this process. Primary research with end consumers (domestic, SME and I&C) could also play an important role and we intend to build on the range of methodologies used in previous price control reviews. These are outlined at a high level in Figure 1 below. We note, however, that this is an area that would be tailored according to the specific needs of different price control reviews and would develop over time as we learned what aspects of the enhanced engagement model were most effective.

5.3. We also note that there are some parties that are not represented by any of the groups outlined in Figure 1 below and we would not want to preclude them from participating directly in the price control review fora. Equally, in the event that parties represented by the groups outlined in Figure 1 had a preference for direct participation in the price control review forum rather than engaging via these groups, they would be able to input directly into these meetings.

**Figure 1: Inputs to the enhanced engagement process**

5.4. The function that each of these fora could perform is set out below.

### Domestic consumers

5.5. We propose to use a range of research methodologies, building on those used in DPCR5, to provide an indication of end consumer views. This is likely to include use of our Consumer First Panel, bespoke workshop sessions to explore particular facets of the price control review, qualitative work with groups of customers with specific needs (e.g. those who have experienced poor quality of service, those dependent on the supply for medical needs) and large-scale surveys. Given the locational spread that these mechanisms include they would provide an opportunity to hear the diversity of consumer views and, where appropriate, could be complemented by further deliberative fora<sup>5</sup>. Ofgem would have responsibility for ensuring views expressed during this process were reflected in discussions at the price control review fora.

<sup>5</sup> Deliberative fora can be used to seek the views of groups of consumers, e.g. domestic or business consumers, and allow participants to formulate opinions about policy options having heard presentations and arguments from a range of experts and key stakeholders.

**End consumer fora**

5.6. The consumer challenge group was established as a pilot within DPCR5 to act as a sounding board for policy development and ensure consumer interests were at the heart of decisions taken about the direction of the price control. The consumer challenge has six members who were appointed on the basis of their expertise in the interests of present and future consumers and energy sector knowledge. Four of the members have a background in household consumer issues and two of the members have expertise in business consumer issues. We envisage the establishment of a similar group as part of future price control reviews. This would build on the experience of the Consumer Challenge Group in DPCR5 and would provide an additional forum for discussion of the policy proposals. If such a forum were developed, the views expressed in these meetings could be used to feed into the price control review fora.

**Business consumer fora**

5.7. The small and medium users group (SMUG) consists of similar size business consumers while the large users group (LUG) largely comprises industrial and commercial consumers. Both groups also include representatives of these respective groups. We think that these fora could provide opportunities for Ofgem to present current policy issues and for consumer groups to discuss and, potentially, agree a position. These views could be fed back to the price control review fora via a LUG or SMUG representative or through Ofgem. As a complement to this, we also propose to use a broad range of research methodologies, similar to those used for domestic consumers, to provide an indication of the views of business consumers. This could include bespoke workshop sessions, qualitative work with groups of customers with specific needs and large scale surveys.

**Consumer representatives**

5.8. We think consumer representatives are potentially best placed to understand and effectively represent the views of the consumers they represent in the price control review fora. This could be facilitated through the SMUG and LUG with Ofgem also feeding in direct views of consumers from our Consumer First Panel, customer surveys and other research. We would also like to see consumer representatives being proactive in understanding the needs of the parties they represent in relation to network regulation.

5.9. Through RPI-X@20 we understand the difficulties that consumer representatives have with only limited time and resource to devote to network regulation issues. To address this, we think it is crucial to provide appropriate support to these parties to facilitate ongoing effective engagement and we see a role for us in doing this. We think this support could be made available to all participating stakeholders, although we recognise that end consumer representatives are the most likely recipients.

Support could take the form of targeted information and, consistent with our better regulation duties<sup>6</sup>, this could be complemented with our commitment to producing accessible, concise consultation documents written in clear, plain English while avoiding jargon to facilitate understanding. There may also be scope for us to offer financial support to these parties recognising the time burden that engagement in the price control review forum, and potentially other engagement, could impose. This would build on arrangements for the consumer challenge group and we will consider the need for this further in working up our recommendations. We intend to make the process as accessible as possible to those without detailed knowledge of the price control framework.

### **Government input**

5.10. Consistent with the independence of energy regulators recently confirmed in the EU Third Energy Package, we will continue to take decisions on price controls independent of Government.

5.11. However, Government sets overall energy policy. A number of parties have suggested that energy network companies, and other stakeholders, need to understand better developments in energy policy and their implications for the future of energy networks. This is true of developments at national and EU level.

5.12. We think there is merit in including Government in our multi-layered approach to effective engagement. At times it may be appropriate to include other regulators, including the EU Agency or other European regulators, in discussions. This would be in addition to our existing engagement with European regulators, our current working arrangements with key Government departments, and our work with other GB regulators including the Health and Safety Executive. The purpose would be to facilitate better understanding of policy by network companies and other stakeholders, using the price review process as an opportunity for discussions on Government policy between all parties engaged on energy network-related issues.

### **Network user input**

5.13. There is a range of network users that may potentially have an interest in participating in the development of the regulatory settlement through the price control review fora. We recognise that there are a number of different fora already established to allow these groups of network users to discuss issues of importance to them. This includes the Energy Retail Association (ERA), the UK Offshore Operators Association (UKOOA), the Association of Electricity Producers (AEP) and the Ofgem-led shipper meetings. We think these fora could be used to allow parties to discuss their views and decide the position they want to feed into the price control review fora. However, as outlined above, we note that they would be able to feed their views directly into the price control review fora if this was their preferred approach.

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<sup>6</sup> Contained in section 3A(5A) of the Electricity Act 1989 and section 4AA(5A) of the Gas Act 1986.

**Other inputs**

5.14. The broad customer satisfaction measure proposed in DPCR5 includes an end customer satisfaction component, an objective complaint metric and a measurement of performance in stakeholder engagement. The outcomes from this mechanism could be used to develop a traffic light system for network companies to measure their performance against each of the indicators. This would help inform discussions as part of the overall price control review fora.

## 6. Next steps

6.1. We recognise that there are many other elements that could be devised to feed into the price control review fora. However, we think it is important to achieve a balance between opportunities for stakeholders to engage and the burden that we place on these stakeholders. We would welcome the views of interested parties on the process for enhanced engagement set out above and on any other available options that could be used to facilitate engagement.

6.2. As part of the work we will be taking forward for our final recommendations, we will work up our thinking on the way that the enhanced engagement process might work in practise. This work will focus on when engagement would take place to ensure that stakeholders could meaningfully influence the outcomes from the price control process but minimise impacts on the timetable for the review. We will also need to give further thought to the process that could be followed and the best way for enhanced engagement to deliver a more informed price control. We would welcome the views of interested parties on the most appropriate way to structure this process.