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RPI-X@20 consultation

26 August 2010

Local Grids and RPI-X@20

Ofgem

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London

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Dear Hannah,

Regulating energy networks for the future: RPI-X@20 Recommendations

ESB International (ESBI) is pleased to respond to Ofgem's recommendations for regulating energy networks for the future. This is an important piece of work with the potential to reduce risk for investors and increase the stability and effectiveness of network regulation. We therefore welcome Ofgem's recommendations and look forward to understanding more detail about how the proposals will be implemented in practice.

In this response we provide a brief overview of ESBI and a summary of our views, before discussing what we see as the key issues in more detail. We would be pleased to discuss any aspect of this response in more detail and look forward to participating in the development of the future regulatory regime.

ESB International

ESBI has been a developer of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for over fifteen years. We currently have interests in Corby power station and in the 850MW development at Marchwood, which commissioned late last year. We also recently announced our latest 860MW development at Carrington which is planned to commission in 2013. We are also developing other large CCGT developments at various locations across GB. It is ESBI's intention to build 3GW of thermal generation in Great Britain in the next decade.

In addition to increasing our conventional generation fleet, we are also seeking to expand our GB portfolio

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Registered in Ireland No. 137736



of renewable generation sites, having recently announced the acquisitions of Fullabrook Down, West Durham and Mynydd Y Betws windfarms. All these developments are set within the context of a wide-ranging programme announced by the ESB group to facilitate the transition to a low carbon economy.

Summary of views

In summary we consider that:

- The RPI-X@20 project has provided a welcome opportunity to assess the effectiveness of regulation in the round and to create a framework which is fit-for-purpose and able to deliver the transparency and stability necessary to facilitate investment in all aspects of the GB energy market.
- It is absolutely appropriate that network companies engage with their customers and those customers have a say in the way networks develop. In our view it will be important to ensure that companies engage with all of their customers and that certain groups do not have a disproportionate influence on company actions.
- While we support the transition to longer price control periods, which we consider can increase stability; we are keen to understand how this interacts with an output based framework. Such a framework seems to imply a less laissez-faire and more interventionist approach, potentially involving frequent changes in the regulatory regime. We also note the considerable challenges likely to be associated with specifying an appropriate package of outputs.
- We are supportive of Ofgem's attempts to introduce contestability into the delivery of network assets and services. Where there are potential opportunities: to provide more customer focussed solutions; to deliver better value for customers; or to find innovative solutions, it seems entirely appropriate that the regulatory regime allows this to occur.
- Including a limited number of targeted incentives as part of the regulatory framework can be effective in focussing network companies' activities on the delivery of specific outputs which are valued by customers. However, we consider that it is important that incentives are only used where they can deliver demonstrable benefits and they should not be a substitute for holding network companies to their licence obligations. We are particularly concerned by the apparent commitment to symmetric incentives in the future regulatory regime.

Detailed comments on recommendations

We now expand on the views summarised above. Our response is structured in generally the same order as Ofgem's document.

Objective

ESBI agrees that any future regulatory framework should encourage energy network companies to:

- play a full role in the delivery of a sustainable energy sector; and
- deliver long-term value for money network services for existing and future consumers.

However, we also consider that, as far as possible, the regime should seek to facilitate competition in the generation and supply markets. From our perspective it is vital that the regulatory regime translates into a stable and predictable set of network charges. Therefore we support longer-term frameworks which lead to relatively infrequent amendments and would be concerned by a regime which led to frequent and unpredictable year-on-year changes in network charges.

Industry Structure

We consider it pragmatic to deliver the proposals under the existing industry structure and to keep the arrangements under review. We do however note the significant amounts of uncertainty about future industry structure and would like to reiterate our responses to previous consultations which have stressed the importance of resolving this uncertainty as soon as practicable in order to create a stable investment climate.

Enhanced engagement

Ofgem's proposals include an enhanced role for stakeholders within the price control process. In principle, we consider that it is entirely appropriate that a network company's activities should be directly influenced by the demands of its customers (as they would be were the company operating in a competitive market). However, we consider that there are likely to be a number of important actions which need to be taken to ensure that the engagement leads to a balanced and well justified set of proposals.

Firstly, it will be important to ensure that the full range of customers have an ability to feed into the process. ESBI would be particularly concerned were network companies to pursue an approach which did not afford all stakeholders the same opportunity to input into the price control process and led to parties which were likely to be supportive of network company proposals being given a disproportionate level of input. As such, we consider that there are arguments for Ofgem seeking to facilitate open forums and for developing guidance on what constitutes best practice.

The biggest challenge of enhanced engagement is likely to involve persuading parties which may feel they have relatively little to gain from a price control process that participating in that process, which can be costly, is worthwhile. If this doesn't happen, then the fear that some parties will be able to unduly influence the process is likely to result. We are therefore of the view that there may be arguments for considering, in limited cases, to compensate parties for participating in this process.

Third party modification requests

We consider that highlighting and issuing guidance about the ability of third parties to request a price control modification reference is a positive development which will help to change the balance of price controls from a negotiation between a network company and Ofgem to a more broad-based stakeholder framework.

We are of the view that there may be merit in considering how different parties may signal concerns and, potentially, in creating thresholds for challenging determinations which are more proportionate to the size of both the issue and party involved. This view arises from a concern that the amount of resource required to submit and participate in the reference process may dissuade smaller parties from raising what may be important issues.

Outputs led

ESBI understands Ofgem's desire to create an outputs led regulatory regime. However, we note that there could be considerable challenges associated with specifying an appropriate package of incentives and consider there could be a potential inconsistency with the desire for longer price control periods.

An outputs led framework would, we presume, link the flow of revenues to regulated companies to the delivery of certain outputs. Assuming that network charges change when revenues flow to companies, it appears possible that the approach could create additional volatility, which may not necessarily be desirable.

We also presume that the package of outputs would be specified by Ofgem. This appears to require a more involved role for Ofgem than one might expect in a regime with long price control periods and greater customer engagement. Experience from other sectors also illustrates the challenges involved in designing an appropriate package of outputs. If overly specific, outputs run the risk of focussing company behaviour on certain activities, to the detriment of others, and could be argued to remove risk from companies (because they are perceived as doing what the regulator tells them to). If too high-level, then they simply become aspirations and have little practical benefit.

Further, we note that some other utilities have introduced outputs-based regulatory models, to varying extents and degrees of success. Where this has been done, the processes for developing and defining appropriate outputs have been long and often iterated over a number of price controls. We are concerned that this uncertainty and possible volatility could lead to a hiatus in network investment at a time when significant work is required to ensure the GB energy networks are able to adapt and cope with the considerable challenges they face over the forthcoming years.

Retaining an ex-ante control

We agree with Ofgem's proposal to retain an ex-ante control and consider this approach to be beneficial in providing certainty and predictability.

Length of the price control

We consider that the move to 8 year price controls is a positive step that will increase certainty and potentially improve decision making by network companies. We do however note that the potential for a re-opener after four years raises the risk that some of these benefits could be eroded if re-openers become the norm rather than an exception. In our view this is a key challenge for the new regulatory framework and a temptation which will need to be avoided in order to develop the credibility of the regime.

Proportionate assessment

We agree, in principle, that price control assessments should be proportionate and recognise the potential benefits associated with more effectively allocating the regulator's resources and creating a more streamlined price control process.

We do however note that there could be possibilities for proportionate assessments to be gamed – by, for example, working for a lighter touch regime during periods with relatively little capital expenditure in order to benefit from the regime in a future control. However, we expect that Ofgem will work to ensure that the approach does not create perverse incentives and will ensure that it is mindful of these incentives when determining the appropriate level of scrutiny for the business plans.

Option to give third parties a greater role in delivery

We are supportive of Ofgem's attempts to introduce contestability into the delivery of network assets and services. Where there are potential opportunities: to provide more customer focussed solutions; to deliver better value for customers; or to find innovative solutions, it seems entirely appropriate that the regulatory regime allows this to occur. We would support the development of clear and simple processes which allow this market testing to take place so that network users such as ourselves can evaluate the most efficient method of ensuring that the infrastructure required to facilitate the connection of our plant is delivered in a timely and economic manner.

Incentives

We have a number of concerns about Ofgem's proposals to use an increasing number of incentives within the regulatory framework and, in particular, the suggestion that incentives should be symmetric in all cases.

We recognise that using a limited number of targeted incentives can be effective in focussing network companies' activities on the delivery of specific outputs which are valued by customers. However, we consider that it is important that incentives are only used where they can deliver demonstrable benefits and they should not be a substitute for holding network companies to their licence obligations. In our view

there has been an increasing trend to introduce incentives and it is not clear that, in all cases, the interaction between these incentives and alternative methods of delivering benefits have been fully considered.

We completely agree that incentives should be calibrated to provide long-term value for money for network users but do not consider that this will, in all cases, be delivered through symmetric incentives. We were surprised and concerned that Ofgem appeared to be committing to a firm position at this stage and had not fully considered the case for “penalties only” or asymmetric incentives.

Principles for ensuring efficient delivery is financeable

Overall we welcome Ofgem’s proposals regarding financeability. We consider that the principles outlined are appropriate and believe that it is sensible for the approach to be reviewed in light of the current financial environment. We also welcome the additional certainty that the financeability principles will provide to the market.

Innovation stimulus package

We understand the rationale for introducing an innovation stimulus package and welcome the fact that it covers both engineering and commercial innovations. We also welcome the proposal that access to the package is not limited to the network companies, but rather that it is available to all parties.

However, we would be keen to understand how the framework will work in practice. In particular we would like to understand the interaction between the innovation stimulus package and the longer price control framework. In our view, it would be unhelpful if the stability benefits which we expect longer-term price controls to deliver were offset by the innovation stimulus mechanism leading to unpredictable changes in the revenues which are allowed to network companies.

Summary

ESBI welcomes the proposals presented in the regulating energy networks for the future: RPI-X@20 recommendations. We consider that the proposals provide a strong basis from which to develop an enduring framework for the effective regulation of the GB energy networks and look forward to working

with Ofgem to develop these proposals further.

Should you wish to discuss this response further please do not hesitate to contact me.

Yours sincerely,

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By e-mail