

## Ofgem's Price Control Review Forum Summary of proceedings

**Venue: Ofgem offices, 9 Millbank, London, SW1P 3GE**  
**Date: 4 November 2010, 14:00 – 17:30**

On 4 November 2010, Ofgem held the first Price Control Review Forum for the electricity and gas transmission price control (RIIO-T1) and the gas distribution price control (RIIO-GD1). This note summarises the proceedings.

### *Key Price Control Review Forum (PCRF) documents*

The following documents were presented and discussed at the PCRF:

- PCRF agenda<sup>1</sup>;
- PCRF slide pack, including questions for discussion<sup>2</sup>;
- the PCRF terms of reference<sup>3</sup>; and
- presentation by RenewableUK on environmental outputs<sup>4</sup>.

The meeting was structured into seven sessions. We set out the main points arising in each session below. Annex 1 sets out the membership of the PCRF.

### *Session 1: What is the Price Control Review Forum (PCRF) and how will it work?*

Ofgem set out the purpose of the PCRF and how it fits into the wider stakeholder process. Members were then asked to respond to the questions set out in the PCRF slide pack. There were several comments made by members focusing on the draft PCRF terms of reference document:

- it would be useful for Ofgem to provide greater clarity on the overall purpose of the PCRF, including how it joins up with the working groups;
- under the new RIIO price control process it is difficult to understand when stakeholders should seek to influence Ofgem's decisions;
- the PCRF format should be flexible based on feedback from members;
- PCRF preparatory material should be sent two weeks before the meeting rather than one;
- there was concern about the use of the word 'trade-off' in the terms of reference. One member asked that the wording be reviewed to reflect the fact that sustainable network and value for money objectives should be not be seen as trade-offs but integrated objectives; and,
- one member was concerned that the PCRF would not be listened to and that Ofgem already had preconceived ideas (e.g. on the REPEX programme) at this early stage in the process.

In response these comments Ofgem highlighted that:

- one objective of the PCRF is to bring together all engagement activities (including decisions at the working groups) to ensure activities are joined up;
- it would seek email feedback from PCRF members to learn lessons from this first meeting;

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<sup>1</sup><http://www.ofgem.gov.uk/Networks/PriceControls/PCRF/Documents1/PCRF%20final%20agenda.pdf>

<sup>2</sup><http://www.ofgem.gov.uk/Networks/PriceControls/PCRF/Documents1/PCRF1%20final%20slide%20pack.pdf>

<sup>3</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/PriceControls/PCRF>

<sup>4</sup><http://www.ofgem.gov.uk/Networks/PriceControls/PCRF/Documents1/RenewableUK%20PCRF%20presentation.pdf>

- summaries of the working group meetings are now available on the website;
- it would consider changing the wording in the PCRf terms of reference – removing the word ‘trade-off’; and,
- the success of the PCRf (including whether it has been listened to) should be judged over time recognising that the final decision and responsibility for it remains with the Gas and Electricity Markets Authority.

### *Session 2: Introduction to the RIIO model of energy network regulation*

Ofgem provided an introduction to the RIIO model and set out the key issues for the RIIO-T1 and RIIO-GD1 reviews. Members were then asked if they had any questions or concerns about the process. We summarise key points of discussion below.

One network company representative highlighted concerns about the RIIO timetable, in particular, the risk that Ofgem’s March Strategy Decision Document was too prescriptive on outputs, reducing network companies’ ability to engage with their stakeholders.

In response, Ofgem noted that the intention of the March decision document was not to be overly prescriptive, but rather give network companies enough information to engage with their consumers to develop their business plan. It was highlighted that network companies, not Ofgem, are expected to make a case for how they can best meet their consumers’ needs, e.g. in terms of service delivery, based on their own engagement.

One member highlighted that Ofgem needed to develop associated incentive mechanisms, as well as outputs measures and levels.

Another member noted that it would be useful for Ofgem to set out key price control milestones alongside other key Ofgem reviews, as well as wider government policy reviews, and their potential interactions.

Several supplier representatives queried whether an output category measuring the financial impacts on suppliers and users due to network charging (particularly due to volatility and forecasting), was missing from the RIIO model. Discussions related to this included:

- network companies’ actions to reduce charging volatility would benefit consumers;
- requiring network companies to inform users and shippers of the expected change in future charges might constitute a useful output. A network company cited work they had done to help suppliers and network users understand the evolution of future charges;
- the RIIO model would increase charging volatility and make forecasting charges more challenging. This is due to the greater use of annual adjustments in the regime; and,
- stakeholders will need to think collectively about how to address this challenge. Ofgem noted that this is something that it could revisit as part of its customer satisfaction output category.

One member was interested in how the amount of allowed revenue set under the price control would break down between the three elements of RIIO – Incentives, Innovation and Outputs. In particular, they noted that there is currently no understanding for how much of total revenue would be attached to incentives. Ofgem noted that incentives will be designed to reward network companies who perform well and impose penalties on those who do not.

One member raised concerns that Ofgem's decision on the whether to fast-track a network company will take place as the economy emerges from recession. They were concerned that a fast-tracked company might be disadvantaged if financing costs and the allowed rate of return increase. In response, Ofgem noted that the RIIO model takes a long-term view on the cost of equity and, as such, any early decision should not be undermined by short-term financial changes. Ofgem also noted that allowed debt costs will be automatically updated through the debt indexation mechanism.

One member was keen to understand how the RIIO model would build in flexibility for changes in government policy that might occur over the eight-year price control – noting that there is uncertainty around the future demand for the gas network. Ofgem explained that the RIIO model has several avenues to address uncertainty including, the use of uncertainty mechanisms and the mid-period review, as well as the disapplication of the price control Licence condition for a company in financial distress.

### *Session 3: Summary of Ofgem and network companies' stakeholder engagement*

In this session, Ofgem presented the findings from its stakeholder engagement. Network companies were then invited to provide an overview of their own stakeholder engagement to date and future plans.

Broadly, network companies are adopting a similar approach to their first phase (between now and early next year) of stakeholder engagement. This includes:

- setting up and running workshops with various consumer groups to:
  - inform them about the networks role;
  - understand how and when different types of stakeholders want to be engaged; and
  - start addressing key issues for network companies (e.g. one network company has held a workshop looking at innovation in electricity).
- exploring ways to develop and make use of existing consumer feedback mechanisms, such as surveys on connection experiences;
- holding bilateral meetings with key stakeholder groups;
- where appropriate, network companies are looking to adopt a collaborative engagement strategy for common areas across the sectors. For example, on Xoserve or shipper issues;
- using company websites to convey key information on engagement; and
- exploring the use of new technology to engage stakeholders. For example, using social network tools to target groups in real-time.

In response to the networks, one panel member suggested that they were not aware of all of the networks' stakeholder engagement processes, and they suggested that the PCRF and/or its distribution list could be used as a means to communicate this information.

### *Session 4: Safety and reliability outputs*

This session focused on Ofgem's ongoing work developing safety and reliability outputs. Ofgem presented its current thinking in this area and asked members to consider the questions set out in the slide pack. Members' views are summarised below:

### *Safety*

Ofgem highlighted that the outputs reflect the companies' legal obligations, as regulated by the Health and Safety Executive (HSE). Ofgem noted that it is not looking to place additional financial incentives or penalties on network companies, or to put a parallel safety monitoring framework in place.

One representative noted the gas safety case allows for proactive monitoring of safety performance. There is no requirement for electricity network operators to produce an equivalent safety case.

It was suggested that it would be useful, when developing electricity safety outputs, to make use of the information that is already available and bring it together in one place. Ofgem considered that the information would best sit as part of the safety monitoring framework under the HSE.

One member suggested that Ofgem should look to propose an additional penalty for network companies having a poor safety record in order to mimic the costs to a company in a competitive market (that would face both compliance action, as well as loss of market share arising from reputational damage).

Ofgem noted that they had considered this issue but their preference was to leave the decision over the penalty to the courts, based on the HSE presenting the case for prosecution. However, Ofgem invited further feedback as part of December's consultation.

Several members noted that if Ofgem were to look to impose an additional penalty on safety breaches, Ofgem should also allow a reward for out-performance on safety issues.

An issue raised by several stakeholders was the area of carbon monoxide poisoning in gas. While this was seen as a difficult area to address as part of the price control, it was seen as an issue that network companies could potentially influence. It was queried whether any output developed for carbon monoxide should be classed as a safety or (as now) social output. Ofgem noted that it would reconsider its classification.

One member highlighted the importance of effective staff training, development and succession planning in ensuring workers' safety. They also highlighted that an appropriate allowance was needed to be set by Ofgem to ensure effective apprentice programmes can be run. Ofgem noted its track record in DPCR5, where specific allowances were included in final proposals.

It was noted that the HSE, in conjunction with Energy Networks Association, would be keen to present ideas at the next PCR5 for measurable indicators for safety outputs for electricity transmission.

### *Reliability*

Ofgem highlighted that the reliability outputs being developed in both RIIO-T1 and GD1 focussed on similar issues. In response to the presentation, members debated several issues which are summarised below.

One member was concerned that no financial incentive has been proposed for entry meter errors or accuracy of mains records. This was seen as an area in network companies' control. In response, a network company noted that they

already face costs where the locations of gas pipes shown on their plans are inaccurate.

A network company noted that imposing financial incentives on energy not supplied (ENS) would be challenging given the small value of ENS.

One network company expressed concern that in setting target output levels, Ofgem would lock in the transmission operator's (TO's) investment requirements before the TO had the opportunity to develop their business plans.

Ofgem noted that there would be flexibility for the network companies to propose and justify the actual output level to be delivered based on their stakeholder engagement and cost-benefit analysis.

#### *Session 5: Presentation by RenewableUK*

In this session RenewableUK gave a presentation to members on the RIIO environmental outputs and key issues around developing them. Their key message was that much of the energy network companies' direct environmental impacts, while more measurable and controllable, were much less material than the networks' impact on meeting the broader environmental and energy targets. The slides can be found on our website<sup>5</sup>. The discussion that followed has been summarised in this note in session 7 on Environmental outputs.

#### *Session 6: Customers, connections and social issues outputs*

This session focused on Ofgem's ongoing work, developing customer satisfaction, connections and social outputs. Ofgem presented its current thinking in this area highlighting that:

- in developing the measure for customer satisfaction it was looking to build on the broad measure developed in DPCR5. It was highlighted that this is more challenging to do in transmission than in gas distribution (e.g. due to proximity to end consumer and the system operator (SO)/ transmission operator (TO) roles);
- in terms of developing connection outputs there are important links between the price controls and Ofgem's Project TransmiT which will be considered; and
- there are currently no social outputs proposed for Transmission.

Members' views from this session are summarised below.

One topic discussed was the challenge of measuring customer satisfaction in Transmission. An energy network company supported the development of a survey given the importance of connecting renewable energy. One member also stated that any output measure should not be about the number of complaints, rather how effective the network companies are in dealing with them. Another member highlighted that any metric developed to measure customer satisfaction should include potential, as well as current, users. A transmission network company noted that they do not generally receive many complaints from end users and, as such, picking up wider stakeholder views will be important.

When developing financial incentives around timely connections one member highlighted the challenge of not creating perverse incentives. For example, an incentive encouraging quick connections could compromise safety.

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<sup>5</sup> <http://www.ofgem.gov.uk/Networks/PriceControls/PCRF/Documents/1/RenewableUK%20PCRF%20presentation.pdf>

There was discussion with regard to whether we need to identify specific output measures in relation to vulnerable customers. Several network companies highlighted that they currently provide service to vulnerable services, e.g. in the event of a supply interruption. However, it was noted that the Working Group had not identified any specific output measures in this area.

#### *Session 7: Environmental outputs*

Ofgem presented its ongoing work in developing environmental outputs. Ofgem noted that:

- understanding what environmental issues are in the network companies' control is vital to developing outputs;
- Ofgem wants network companies to play a full role in delivery (striking the right balance between anticipation and waiting for certainty); and
- given the level of uncertainty about the best way forward to meet environmental targets, it will be important to encourage network companies to work with stakeholders to navigate the optimum path.

For electricity transmission there was considerable debate in the Forum around the extent to which network companies should be proactive in building network capacity ahead of demand. Several network companies noted that there is no need to build new wires in advance of renewable generation. Once the generator is ready to ship, then the terms under the connections incentives should mean capacity will be forthcoming in a timely fashion.

However, one member highlighted the work of the Committee on Climate Change and the recent progress report on delivering carbon budgets. It was noted that this report sets out concerns about the timely delivery of transmission infrastructure, including the delay of funding for the Electricity Networks Strategy Group (ENSG) projects. The member was interested to understand what was causing the delay to network investment, and stressed that the renewable targets are clear and, as such, the network companies should not be so concerned about making anticipatory investment as the generation will ultimately be there.

In response to these concerns, several network companies highlighted that funding of ENSG projects was not being held-up by the Ofgem approval process. However, how Ofgem would need to consider how the current project-by-project approach for securing approval is adapted for RIIO-T1. The ENSG project and associated funding arrangement was also seen as a good example of network companies being proactive in seeking to help facilitate delivery of the government's environmental targets.

Members then considered whether there should be a financial incentive for network companies to play a role in delivering a low carbon economy. Several environmental stakeholders expressed concern that there were not sufficient financial incentives being proposed to deliver the RIIO outcomes. One member noted that one of the key reasons for moving to the RIIO model was to help facilitate the delivery of a sustainable energy sector and, as such, it is strange that there is no primary output linked to this.

In response, Ofgem said that the RIIO model includes a number of different interactions that relate to the meeting of these targets (e.g. an output around the timings of network connections). In addition, other areas of the model are intended to help meet the sustainability challenges (e.g. the innovation stimulus fund). However, there is concern that given the uncertainty, funding the development of network extensions before committed generation, could pose significant risk to consumers.

One network company member expressed concern about introducing incentives to encourage them to build additional network ahead of generation, highlighting that this could drive perverse behaviour and potentially require a higher cost of capital to reflect the increased risk. They suggested that instead, incentives need to be targeted to ensure network companies do not act as a barrier to connecting generation.

Several members questioned whether meeting the sustainable energy targets meant all effort should be focused on building new network to service wind energy in Scotland. It was noted that this is likely to increase costs for consumers. One member questioned whether this was a matter for the price controls, while other members suggested more strategic government policy was needed to reduce the uncertainty about the best way forward to meet the sustainable energy targets. Related to this, one network company noted that it is difficult to try and put incentives on network companies given this uncertainty. Another member highlighted concerns around the Renewables Obligation Certificate (ROCs) policy, suggesting this could act as an artificial incentive to drive network companies to build networks to cater for wind demand, ahead of other potential renewable sources such as wave.

Ofgem was questioned by one member as to why they were not proposing a primary output on visual amenity in electricity transmission. One member supported a measure around the length of wire undergrounded in naturally important landscape areas and stated that they would propose a practical output measure.

Ofgem noted that it is the Planning Committee's remit to decide whether wires should be undergrounded. However, it was noted that changes to the planning process may present more opportunities for network companies and Ofgem in this area. Other issues raised on visual amenity included:

- it would be difficult and expensive to develop incentives to underground wires;
- the use and value of willing to pay surveys was questioned in light of the experience in other sectors (e.g. water); and
- the planning process does not deal with existing electricity wires and, as such, Ofgem should look to develop something for electricity transmission, akin to the existing undergrounding incentive in DPCR5.

One gas distribution company was broadly supportive of the proposed environmental outputs. Another member supported the absence of a financial incentive/penalty on aggregate going to landfill, as they considered that this issue is already addressed by the landfill tax.

#### *Other matters*

Two PCRf members were unable to attend the meeting and submitted the following comments. These comments were not discussed at the PCRf and are summarised below:

- strong reservations that all incentives used to deliver prescribed outputs are symmetrical;
- visual amenity should not be included in the proposed environmental output. It is a planning issue and for the TOs to determine what the most appropriate and cost-effective solution is to comply with planning requirements;
- interest in the gas emergency service having and using equipment to test appliances for carbon monoxide poisoning and for leaks of natural gas. It

is understood that Scotia Gas has equipped its personnel with personal alarm monitors. Has this been successful and are any of the other gas emergency providers doing the same?;

- financeability was seen as being a key element of the price control. It was felt networks should, where possible and practicable, facilitate the transition to a low-carbon economy but this should be set within the context of them being efficient and financially sustainable for both the TOs and other connected users. Does this issue have interactions with Ofgem's review and possible reform of network use of system charging arrangements within Project TransmiT?; and
- the output measures proposed should not explicitly or implicitly favour any one type of class of generation technology.



**Annex 1: Membership of the PCRf**

<b>Name</b>	<b>Organisation</b>	<b>Representing</b>
Steve Edwards	WWU	Gas Distribution network company (GDN)
Colm Gibson	LECG	Consultant
Rob McDonald	SSE/NSHEB/Scotia	Transmission operator (TO)
Scott Mathieson	SPT	TO
Paul Whittaker	National Grid	TO
Stephen Parker	NGN	GDN
Martin Atkinson	SBGI (onshore gas industry)	Onshore gas industry
(One of) Paul Hawker/ Nicola Robinson/ Tom Luff	DECC	Central Government
Jonathan Stern	Committee on Climate Change	Environmental groups
Either Guy Nicholson/ Alex Murley	RenewableUK	Renewable energy producers
Ulrika Diallo	Federation of Small Businesses	Small energy users
Either Tim Dewhurst/ Philip Davies	Centrica	Supply businesses
Either Lynn Griffiths/ Tony Brunton	CO-awareness	Carbon monoxide issues
Eddie Proffitt	Major Energy Users Council	Medium and Large Energy users
Gary Smith	GMB	Unions
Colin Connor	HSE	Government
Either Stefan Leedham/ Paul Mott	EDF	Electricity generators. Gas shippers and Distribution network operator (DNO)
Either Richard Hall/ Cem Suleyman	Consumer Focus	Consumer Groups
Ruth Chambers	Campaign for National Parks	Local and national environmental groups
Simon Roberts	Ofgem's Consumer Challenge Group	Specialists in consumer issues
Michael Dodd	ESBI	Electricity generators
Either Nigel Cornwall/ Ed Reed	Cornwall Energy	Small Energy Suppliers
Helen Inwood	RWE npower	Supply businesses
Jacopo Vignola	Centrica storage	Gas storage