

Ofgem's Price Control Review Forum Summary of proceedings

Venue: Ofgem offices, 9 Millbank, London, SW1P 3GE

Date: 24 January 2010, 13:00 – 16:00

On 24 January 2010, Ofgem held the second 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 agenda¹
- PCRF slide pack, including questions for discussion²
- presentation by EDF energy on the views of Generators and Shippers on the proposed RIIO-T1 and GD1 outputs and incentives³
- presentation by Campaign for National Parks on willingness to pay research on designated landscapes and RIIO-T1.⁴

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

Session 1: Introduction

Ofgem highlighted that the focus of this PCRF was to provide feedback on the proposals set out in the RIIO-T1 and GD1 December consultation documents. It was noted that, as well as the PCRF, bilateral meetings will continue to form an important avenue for stakeholders to engage with Ofgem. Members were encouraged to setup bilateral meetings to discuss more detailed aspects of policy development.

A brief overview was given by Ofgem to highlight some of the areas that were discussed at the previous PCRF and how they had been taken forward in the consultation documents.

Session 2: Summary of network companies' stakeholder engagement

In this session, network companies were invited to provide an overview of their own stakeholder engagement to date, how they were intending to use this information to inform their business plan submission, and their future stakeholder engagement plans.

Network companies reported they were undertaking a range of different stakeholder engagement activities, a view affirmed by the experiences of some members of the forum. They are employing a variety of techniques, which differ between network companies, to elicit stakeholder views. Reported programmes/events being run to identify stakeholder views included: issuance of survey cards after carrying out a visit to an end consumer; online forums to

¹ www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/PCRF2%20final%20agenda.pdf

² www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/PCRF2%20final%20slide%20pack.pdf

³ www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/EDF%20Energy%20presentation.pdf

⁴ www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/Campaign%20for%20National%20Parks%20presentation.pdf

address some of the points raised by consumers; large stakeholder events along with meetings with important stakeholders on a one-to-one basis.

From the engagement undertaken to date network companies have identified the following key issues:

- a number of network companies reported that a limited understanding of what network companies do exists. Educating stakeholders as to their role was a necessary first step of stakeholder engagement
- one network company reported that 88% of stakeholders preferred engagement to be undertaken by web based means but this should be complemented by events
- consumers seek a safe and reliable network with any interruptions to service being minimised. More advance notification of planned interruptions was a recurring theme
- one network company reported that performance, the effect on costs and the efficiency in how the network company operates were the main areas identified by stakeholders
- a feeling exists that connection costs are high, the process of connections is very long but the workforce is very good
- consumers were largely supportive of work carried out to enable renewable development.

Network companies noted they would undertake further work into these areas, the results of which would inform their business plan. One member warned that it would be difficult for network companies to undertake a comprehensive stakeholder engagement programme and incorporate all the findings into their business plan submissions. He cited the large number of other Ofgem and external projects running concurrently, eg Project TransmiT and the Electricity Market Reform, which will invariably involve the same personnel.

One member of the forum was interested if network companies were seeking the views of their employees as part of their stakeholder engagement. Another member was particularly interested if the gas distribution engineers had been consulted after the cold weather in December, discussed in more detail in session 4. One network company responded that employees were not addressed as a separate group but that they had been made aware of the programmes being run.

Session 3: Presentation by EDF Energy

In this session EDF Energy gave a presentation to members on the broad view of generators, shippers, suppliers and developers on the RIIO proposals. The slides, which set out issues across several areas of the price control, can be found on our website⁵. The key areas that spurred discussion amongst members are summarised below.

Environmental outputs

The presentation highlighted that Ofgem should ensure that any environmental incentives should be in addition to network companies corporate commitments. Customers should not be asked to fund areas already signed off by network company shareholders. One member queried whether this was a general comment or related to specific environmental areas of the network companies operations.

⁵ www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/EDF%20Energy%20presentation.pdf

In response, a network company gave some examples of their corporate commitments including, a reduction in its carbon footprint by 50% and minimising the visual impact of their power lines. They also noted that as part of their business plans the money they will seek recover will only be to meet their legal environmental obligations. Activities beyond these obligations would be funded by shareholders.

The presentation suggested that Ofgem should not provide preferential incentives to particular forms of generation. Any incentives should be technological neutral. A consumer representative agreed with this view, noting that government policy should also bear this in mind if it looking to deliver value for money to consumers.

In gas distribution it was also highlighted that there should be a review of the appropriateness of deep versus shallow connection charges. The current arrangements for gas distribution have deep connection charges. This was seen as providing incentives to biogas developers to connect to electricity distribution instead of the gas network as there is a shallow connection boundary in electricity distribution. A consumer representative noted that while this point was valid, any change to the arrangements would need to consider the tradeoffs of altering the existing arrangements, eg increasing the risk of stranded assets.

[Further member discussion on environmental outputs is also summarised in session 4 below.]

Reliability & availability

The presentation considered that in gas transmission there should be a review of whether the definition of 1 in 20 peak winter demand is still appropriate given climate change. This was seen as vital to ensure that investment in the gas network delivers appropriate levels of flexibility.

In response, several members discussed the implications of climate change on peak demand and whether it would lead to 1 in 20 events being more or less common. A couple of members noted that the Met Office are undertaking work looking at extreme weather and that any review of the one in twenty requirements would provide a good opportunity to join up with this work.

One network company noted while peak flows have been an issue recently, over the medium term it is unlikely to be a big driver of costs – with peaks likely to drift down in response to lower demand.

Customer satisfaction (xoserve)

The presentation highlighted that for shippers xoserve is a critical service provider, but for GDNs this is not the case. It was suggested that at a minimum, governance of xoserve should reflect the views of shippers and that Ofgem should consider whether xoserve's funding arrangement should be based on a separate price control.

In response, a network company noted that as part of the ongoing programmes of price control stakeholder engagement, the future role of xoserve is being considered.

Session 4: Discussions on specific areas of the December consultation documents

This session was structured around areas of interest that PCRF members highlighted to discuss prior the forum:

- environmental outputs
- safety outputs and Repex
- Customer satisfaction outputs
- uncertainty mechanisms
- innovation.

Ofgem briefly highlighted the current thinking in each of these areas and then invited members to debate their views of our current proposals.

Environmental outputs

An environmental group noted that various tools could be introduced within the price controls to incentivise network companies to contribute to the low carbon agenda, eg market based measures or secondary deliverables. They had no view on which low carbon incentive was the right one at this stage. However, their stakeholder engagement found that timeliness of connection was very important.

RenewableUK provided an update on their proposals for their Low Carbon Economic Incentive (LCEI) measure. (These proposals seek to address how to incentivise network companies to play a role in reducing CO₂ emissions. The impact of the speed and cost of the transmission activities were identified as perceived areas that could influence this.) They stressed that the incentive was not seeking preferential treatment for renewables but rather an incentive on meeting the environmental targets.

A consumer representative cautioned against using a financial reward on low carbon. They believed that the lack of controllability would result in windfall gains and losses. If network companies could influence meeting government targets then a two-sided financial incentive should be imposed. One member of the forum didn't believe government environmental targets could be met and sought that this was addressed in a credible manner. They advised the emphasis should be on ensuring timely and efficient connections rather than ensuring a large number of new connections. A consumer representative was broadly happy with the output measures from gas distribution.

An environmental group expressed their disappointment that there was no visual amenity output measure and felt that a very important issue had been ignored. Ofgem noted that in the TOs planning process visual amenity is incorporated in the analysis but welcomed ideas in how increase this role. A major energy user representative said this area should be dealt with under the existing regime rather than being incorporated in a price control. Another member noted that National Grid is paid to implement the planning regime proposals and offer the best service to customers.

A gas distribution network company noted that the greenhouse gas potential of methane was 23 times more damaging than that of carbon. They felt that the incentive framework surrounding methane leakage under current proposals does not reflect this because the price increase may be offset by a reduction in the cap and collar. Ofgem noted that the price increase reflects the move to the use of DECC's non traded value for carbon and it was consulting on whether a reduction in the cap and collar. Several members of the forum highlighted the importance of technology neutrality so that cross subsidies are not provided to biomethane.

Safety outputs and Repex

A safety group noted they were comfortable with the measures proposed for gas distribution. However, for transmission they had reservations about how effectively positioned the main safety measure around asset risk was. They thought this stemmed from the different regulatory regimes under gas distribution and transmission.

A union representative noted that during the recent cold weather there was insufficient labour in the gas distribution industry. They cited record gas escapes in the North East and the North West and union member reports that not all labour working to resolve these issues were fully trained, posing a potential danger to workers and communities alike. They raised concerns that operating pipes at lower pressure in the summer and then increasing them for the winter increases gas escapes. Since neither Ofgem nor the HSE have a measure around how quickly a gas escape is repaired after it is reported they queried how Ofgem would be assured of having accurate information to make decisions on the repex/mains replacement programme.

The union representative strongly challenged the value of a report on repex, commissioned by Centrica, on the grounds of its content. The Centrica representative responded that the report's focus was a wider context than just repex.

A gas distribution network company acknowledged that December had been an exceptionally busy month for call outs and they had sought spare capacity from other network companies but there was none available. They queried whether they should have a greater role in providing on site consumer support once called out to deal with a gas emergency. In response, a union representative commented that greater communication between suppliers and gas distribution networks was required and that by educating consumers, eg how to defrost their boiler, a number of call outs could have been reduced.

In response to a recent MP's comments that we do not collect data on escapes or repairs, Ofgem highlighted that reporting data for winter 2010 would be submitted formally by the GDNs as part of their regulatory reporting in July. It was noted that the HSE and Ofgem are currently looking at the iron mains replacement programme and had appointed consultants (CEPA) to lead on this review. CEPA are due to conclude their review in March. The HSE representative noted that their repex review would recognise value for money issues but would be based on safety.

Customer satisfaction outputs

A consumer representative group highlighted concerns that the discretionary reward for the stakeholder engagement element of the broad measure only presented an upside incentive to the network companies. In response, Ofgem noted this was a complicated and qualitative area, which was why it was a reward only. The consumer representative group also noted that it was appropriate to only provide a penalty, for the proposed output measure for complaints in RIIO-GD1.

Several members highlighted that any discretionary reward for stakeholder engagement needs to be based on demonstrable outcomes of network companies' activities. It should not be a 'box-ticking exercise' about the number of meetings. A representative of energy users highlighted their experience of the ongoing network company engagement as part of DPCR5. While they saw the

engagement events taking place as well-run, they were concerned that they were not getting a clear view of the outputs coming out from them. In response, Ofgem noted that demonstrating outcomes would be key for network companies to be considered for such a reward.

Other issues raised on the customer satisfaction discretionary reward included:

- a couple of members noted that the incentive of up to 0.5% of allowed revenue appeared a significant sum of money to attach to a qualitative area
- one key area to measure as part of the reward is how stakeholders' views have been taken into account in network companies' business plans
- one member suggested that it would be challenging for networks companies to obtain feedback from customers on what they have done well, as opposed to what they have done badly
- one member noted that the incentives in place for DPCR5 cause prices to rise on annual basis without any demonstrable improvements in the service quality they receive.

Uncertainty mechanisms

An energy supplier raised several concerns about the RIIO-T1 and GD1 uncertainty mechanism proposals:

- while the consultation documents had considered how to manage network company uncertainty, there was not enough on the impact the uncertainty mechanisms might have on end consumers. The additional price volatility that would result might outweigh the gains of having the mechanisms in the first place.
- more detail is needed on the use of revenue profiling to smooth network charges. It was felt that this should be developed into a more mechanistic process.
- customers are requesting longer-term energy contracts but this looks even more challenging under RIIO proposals. Efforts to reduce volatility and improve predictability would benefit consumers since they could be offered more, and better value, products.

One member noted that charging volatility and predictability was an important issue for generators as they are unable to pass these charges onto consumers. They also noted that Ofgem needs to be aware of the interactions of this area with Project TransmiT.

One member asked what would happen if a network company choose not to accept Ofgem's mid-period review proposals. Ofgem highlighted that this would be subject to the same challenge process that exists for a network company rejecting Ofgem's final price control proposals. It was also noted that at the mid-period it would be at the discretion of the Competition Commission to determine whether it would investigate the whole price package or a specific element of it.

Innovation

A consumer representative supported the reduction in the maximum funding from the innovation stimulus being 80% of the project value. Another member suggested that the innovation stimulus fund proposals should allow funding to be spread more widely than just renewable technologies. In response, Ofgem noted that it would welcome the views of stakeholders on the appropriate scope of the fund.

One member queried the types of project the innovation stimulus would fund given their perception that gas use is set to decline markedly. Several members challenged this view on gas demand and noted that innovation in the sector is still important.

Session 5: Presentation by Campaign for National Parks

In this session, the Campaign for National Parks gave a presentation to members on willingness to pay research on designated landscapes and RIIO-T1. The slides can be found on our website⁶.

The presentation highlighted why Ofgem should create an allowance, similar to that for distribution, to fund the undergrounding of transmission electricity lines in National Parks and Areas of Natural Beauty. Key issues included:

- that there is a lack of willingness to pay research on transmission assets and Ofgem should commission some to inform the price control
- there is increased interest in undergrounding lines, including National Grid reviewing its approach to undergrounding and a new government study (to be published shortly) on the cost of undergrounding
- it would be straightforward to develop an output measure, eg the length of wire undergrounded in nationally important landscape areas
- that willingness to pay benefits are not only local
- it is not about undergrounding all transmission lines, rather consideration in 'priority areas'.

One network company noted that undergrounding power lines has been a key area of interest for stakeholders during their engagement with them to date. They noted that they should do some willingness to pay analysis and that this would be important to get a clear view of the tradeoffs involved when deciding to underground a line. Another network company noted that they are gathering information to inform their business plans, which might help them to decide if there is a case for undergrounding certain lines.

Several members questioned the assertion that the benefits of undergrounding are national. It was also highlighted that undergrounding is an area that should be left to the planning process and not Ofgem. However, a member noted that the planning process does not deal with existing electricity wires.

Another member suggested that there may be ways for local residents, impacted by overhead power lines, to make direct contributions to have them undergrounded.

One member was concerned that undergrounding might become the 'norm', seen as an easy option for network companies to address their planning concerns. If this were the case, it would have significant impact on the level of network charges.

Ofgem wrap up of PCRF

Ofgem highlighted the next steps for both of the price controls, noting that after the publication of our Strategy decision document in March, the next stage will be for the network companies to develop their business plans.

⁶www.ofgem.gov.uk/NETWORKS/PRICECONTROLS/PCRF/Documents1/Campaign%20for%20National%20Parks%20presentation.pdf

In order to reflect the networks companies' work developing their business plans, it was suggested that the next PCRf meeting should be held in mid-May. Ofgem will send out dates for this soon.

Annex 1: Membership of the PCRF

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